

THE IMPACT OF LITIGATION ON FIXING Y2K

JOINT HEARING
BEFORE THE
SUBCOMMITTEE ON TECHNOLOGY
OF THE
COMMITTEE ON SCIENCE
AND THE
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION AND TECHNOLOGY
OF THE
COMMITTEE ON GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

MARCH 9, 1999

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ERRATA

On the title page, the words "Subcommittee on Government Management, Information and Technology" should read "Subcommittee on Government Management, Information, and Technology".

On the title page, the Government Reform Committee's serial number should have been listed. That serial number is:

Serial No. 106-42

On the title page, the words "Printed for the use of the Committee on Science" should read "Printed for the use of the Committee on Science and the Committee on Government Reform".

The Government Reform Committee's list of membership should have been listed on page (III), instead of the contents. It now appears following this information.

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JOINT HEARING ON THE IMPACT OF LITIGATION ON FIXING Y2K INITIATIVES

TUESDAY, MARCH 9, 1999

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON TECHNOLOGY, COMMITTEE ON SCIENCE, AND SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY, COMMITTEE ON GOVERNMENT REFORM, WASHINGTON, DC.

The subcommittees met, pursuant to notice, at 2:10 p.m., in room 2318, Rayburn House Office Building, Hon. Constance Morella presiding.

Chairwoman MORELLA [presiding]. I am going to call to order the Technology Subcommittee of the Science Committee.

Today our House Y2K working group, made up of the Technology Subcommittee and the Government Management Information and Technology Subcommittee, is holding the first House hearing on the impact of litigation on fixing the Year 2000 computer problem.

I am pleased to once again join with my distinguished colleague, Mr. Horn of California, in our series of ongoing Y2K hearings. I do want to point out that with the adverse weather situation, please know that this hearing is being Webcast on the Internet so that there may be people who still have access to it.

Three years ago, when we began our review of the Y2K problem, one of our very first joint hearings dealt with the consequences of Y2K failures, including legal liability. At that hearing, and at others, we discovered that the fear of potential legal liability created a disturbing chilling effect that froze private industry from sharing important Y2K information with each other and with the American public.

Witnesses testified that the risk of failure and its liability consequences, including both punitive and compensatory damages has created a large Year 2000 cottage industry for lawyers waiting to file suits.

In fact, with the total corrective cost estimate ranging from the J.P. Morgan figure of \$200 billion to the Gartner Group forecast of \$300 billion to \$600 billion, the Giga Group estimates that the total cost of litigation could amount to several trillion dollars if there are Y2K disruptions.

It should then come as no surprise that certain industries had refused to acknowledge or share Y2K information for fear that such disclosure could ultimately leave them vulnerable to negligence and warranty suits. By resisting the exchange of technical advice with one another, it delayed the pace of repair work. And that is why the Congress enacted the Year 2000 Information and Readiness

(1)

Disclosure Act last year in an attempt to encourage the widest possible dissemination of Y2K information by giving unlimited immunity from lawsuits to companies that share information about the problem in good faith.

I think that last year's enacted law was a necessary first step in the Congressional review of the Year 2000 liability issue. And while the Act was narrowly tailored to address just the issue of information exchange and does not affect the greater liability questions, I think it is important that we fully explore the legal issues associated with Y2K because the fear and cost of fending off lawsuits is blocking Y2K compliance efforts.

I see the numbing prospect of becoming a Y2K litigant is overtaking in scope and attention the corrective efforts necessary to be Year 2000 compliant, resulting in a great deal of uncertainty, even where there may be no actual Y2K failures. I know that addressing legal liability legislatively will not be an easy task. We must continue to encourage all businesses to devote their full resources and commitment to solving the Year 2000 problem.

Businesses should not be sitting around in expectation of enacted legislation that has the potential of unburdening them from liability. If we are to eventually enact legislation, we must not provide companies an easy out for failing to perform Y2K remediation in a timely and effective manner.

It concerns me and I think all of us that the legal battles have already begun. For example, several software companies are facing lawsuits for breach of warranty, fraud, and unfair business practices because they charge clients for the upgrades necessary to correct the millennium bug. In a Warren, Michigan, grocery store, the Produce Palace, sued the manufacturer of its cash registers because the machines rejected credit cards with Year 2000 expiration dates.

Additionally, the Gartner Group has estimated that there already have been several hundred Y2K litigation settlements, and we are still 300 days away from the beginning of the millennium, when the great majority of Y2K failures, if there are any, would take place.

The fact is lawyers know how to litigate, and the Year 2000 problem may open the floodgates for a new generation of lawsuits that will make asbestos or Superfund litigation look like small claims court.

We have a very important issue before us this afternoon. I am looking forward to engaging in a dialogue with our distinguished panel. I welcome them, despite having to brave today's snowstorm, maybe particularly because they braved today's snowstorm.

Our first witness will be Mr. Tom Donohue, President and CEO of the United States Chamber of Commerce, the largest representative of small, mid and large businesses in our nation. Following Mr. Donohue will be Professor Walter A. Effross, Professor of Law at the American University, Washington School of Law, who is a colleague of my husband's and the chairman of the American Bar Association's Subcommittee on Cyberlaw. Our third witness will be Ms. Abbie Lundberg, who is the Editor-in-chief of CIO magazine, which serves corporate and government chief information offices and chief executive offices. And then next on our witness panel will

be Mr. Howard L. Nations, who is an attorney from Houston, Texas, and the former Vice President of the American Trial Lawyers Association. Our panel will conclude with Mr. Walter J. Andrews, partner and co-chair of the Year 2000 Practice Group at Wiley, Rein and Fielding, a law firm here in Washington, D.C.

So, again, I thank you all for attending, and I now turn for any opening comments you may have to the co-chair of this hearing, Mr. Horn.

Mr. HORN. Thank you very much. We appreciate these fine facilities we are in in the Science Committee, and we look forward to the witnesses. I have read most of your statements, and they are immensely helpful.

One of the most daunting challenges associated with the Year 2000 computer problem involves the issue of liability. Despite passage of the Year 2000 Information and Readiness Disclosure Act last October, some companies remain unwilling to share critical information that could assist others in preparing their computers for January 1, 2000. They fear being held legally responsible.

Hearing after hearing, witness after witness, we have heard of the difficulty that those in our Federal Government have had in obtaining Y2K status information from vendors and suppliers. Time and again, they attribute this lack of critical information to a genuine fear of debilitating lawsuits.

Of equal concern, many companies fear sharing information that could be helpful to others also attempting to bring their computer systems into the Year 2000 compliance. Again, the issue is liability.

Congress must cautiously find the delicate balance, if any, before we act and before we recommend legislation.

Indeed, the potential liabilities appear limitless, even for those who are responsibly attempting to ready their computer systems for the Year 2000.

From contracts that ignore Year 2000 liability to the denial of insurance claims, the avalanche of litigation could virtually eclipse the cost of the problem itself. Some estimate that Year 2000 liability costs could reach \$1 trillion. We cannot afford that cost. Nor can we afford to pit consumer against business, and business against manufacturer.

It takes highly unusual circumstances to justify the Federal Government tinkering with the legal system that, although imperfect, works.

The global scope of the Year 2000 computer problem may, in fact, be such a case. But any change in the law must not relieve anyone—or any company—from the responsibility of updating their systems by the unstoppable deadline of January 1, 2000. The urgency of time, however, must not overshadow the need for careful deliberation of the liability issue.

I look forward today to hearing the testimony of our witnesses who represent our nation's business and legal communities.

[The statement of Mr. Horn follows:]

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“The Impact of Litigation on Fixing Y2K”

CHAIRMAN STEPHEN HORN
OPENING STATEMENT
March 9, 1999

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I look forward today to hearing the testimony of our witnesses who represent our nation's business and legal communities.

Chairwoman MORELLA. Thank you, Chairman Horn. It is now my pleasure to recognize the distinguished Ranking Member of the Technology Subcommittee, Mr. Barcia.

Mr. BARCIA. Thank you very much, Chairwoman Morella, Chairman Horn. I want to join my colleagues in welcoming everyone to this afternoon's hearing. I am not going to belabor the importance of the magnitude of the Year 2000 computer problem. Everyone in this room is aware of the scope and seriousness of this issue. Otherwise, you would not be here this afternoon.

We have come a long way together since our committee initiated its series of Y2K hearings. The Federal Government has invested a significant amount of time and effort into renovating its computer system. Large private sector companies have been acting aggressively to address their systems, and there is a general level of public awareness surrounding the Year 2000 problem.

Today's hearing actually shows just how far we have come in this Y2K odyssey. Today's hearing does not focus on what government has or has not done. Nor does it address private sector actions. Rather, this hearing focuses on what could happen after January 1, 2000, in terms of legal liability. The relevance of this liability issue has been highlighted by a few recent and well publicized Y2K related testing problems that have variously resulted in the operational shutdown of a nuclear reactor, mistakenly sent bills, and heightened awareness of a myriad of problems associated with the health care industry.

A review of today's testimony highlight two points: that like the interrelated nature of computer networks, this is a very complex issue; and secondly, there is not a consensus on how to best deal with the Y2K liability issue.

I hope our witnesses can address one very basic question today and that would be, how are Y2K liability concerns actually hindering companies' abilities to make their operations Y2K compliant?

I want to thank all of our witnesses today, a very distinguished panel of expert witnesses you have assembled, Madam Chairwoman and Chairman Horn, on the Y2K issue. I want to thank all the witnesses for appearing before us today and look forward to your testimony. Thank you.

Chairwoman MORELLA. Thank you, Mr. Barcia. I am now going to recognize Ms. Biggert from the State of Illinois, who is the vice chair of the Government Management Information and Technology Subcommittee.

Ms. BIGGERT. Thank you, Chairman Morella, for the opportunity to discuss this very important issue, Y2K liability. I commend both the Chairman and the co-chairman, Steve Horn, for the work they have done to bring this issue of Y2K readiness to the forefront. The subcommittees have held a series of hearings on Y2K compliance at federal agencies, and I believe it is because of the subcommittee's increased attention to this issue that many of our federal agencies have made significant progress in their efforts to ready themselves for the Year 2000 date change.

But today's hearing is the Congress' first on a related Y2K issue, the issue of liability. I strongly support the committee's effort to address this issue, one that will affect all of our nation's businesses

and consumers. Dozens of Y2K-related lawsuits have already been filed in the United States, and estimates of the total cost associated with the Y2K litigation approach \$1 trillion. Comparatively, the total annual direct and indirect cost of all civil actions in the United States is estimated to be \$300 billion.

In my former life, I was in the Illinois State legislature, and during the time in the legislature, I sponsored several bills, including the Y2K liability reform and general tort reform. And I strongly believe that the Y2K liability has the potential to discourage effective actions on Y2K compliance. But I believe that rather plaintiffs and defendants in Y2K legal actions need to work together to find solutions to the problem.

I look forward to the testimony in today's hearings to determine how the liability issue is affecting Y2K compliance, and I am hopeful that our witnesses will be able to shed light on the specific legal challenges relating to continuing computer capacity in the new millennium. Thank you all for being here, and we appreciate the opportunity to hear from you and to ask specific questions on the issue of liability.

Chairwoman MORELLA. Thank you, Congresswoman Biggert. I now turn to Mr. Turner, the gentleman from Texas, who is the Ranking Member of the Subcommittee on Government Management, Information, and Technology.

Mr. TURNER. Thank you, Chairwoman Morella and Chairman Horn and our witnesses who have gathered here today. This is an important hearing, and it is one that is certainly on the minds of many members of Congress as we approach January 1 of 2000. I am confident that there are many types of potential liability arising from Y2K failures and that many of those potential cases of liability are very diverse, and in many ways unknown. They range from claims against hardware and software vendors, consultants, and service providers—claims for breach of warranty, misrepresentation and fraud, deceptive trade practice, and even personal injury and property damage; claims against corporate boards of directors and management for breach of fiduciary duty.

All of these are, indeed, possibilities. Product manufacturers, insurers, banks and financial institutions, software licensees and landlords of buildings with electronic or computerized systems all could have potential liability. Because the potential scope of liability is so broad and the factual circumstances of every conceivable case varies so widely, Congress should indeed move very cautiously in this particular area.

The unintended consequences of legislation in this area could be as significant as the perceived consequences of inaction, and as a former member of the State of Texas legislature, I fully appreciate how Congress must always respect the fact that States should have the first right to determine their own tort law and to preempt State law is certainly something that I as a former member of a legislative body am very cautious about.

That is not to say that we do not have potential problems and that they should not be addressed by this Congress. But limiting the traditional standards of liability should not encourage companies to avoid their rightful responsibility to inform their customers and their users of the products of potential problems. And legisla-

tion should not be crafted that hinders appropriate repairs to systems that are currently non-compliant.

Small businesses should not be deprived of the protections of existing law that give their vendors and the consultants to those small businesses possible incentives not to disclose and not to make the appropriate repairs before the new millennium. Unlimited liability protection could potentially cause some software companies and other manufacturers simply to ignore the problems of small business. So, in this area, I am convinced that while we need to be very mindful of potential problems, we also need to be sure that the remedy that is carved is not worse than the perceived problem. We must be careful not to deprive consumers and small businesses that experience Y2K injuries and losses the same rights and remedies that are afforded to other injured parties in our legal system. Thank you, Madam Chairwoman.

Chairwoman MORELLA. Thank you, Mr. Turner. I now recognize Mr. Ose, the gentleman from California.

Mr. OSE. Thank you, Madam Chairwoman. I appreciate being here today. I have a couple questions and they really boil down specifically, to which I hope the panel will respond, is how to increase the supply of qualified contractors who are available to fix this problem? I do not know what the Section 505 stuff deals with, and I do not know how to ask a question about that, but my concern is how do we increase the number of people who can help cure this problem? Thank you.

Chairwoman MORELLA. Our panelists will probably in the course of their discussion attempt to respond to that. I am going to ask you if you would rise because we have a policy in the Science Committee and the Government Reform Committee that we swear in all of those who are going to testify. So if you would rise and raise your right hand. Do you solemnly swear that the testimony that you are about to give is the truth, the whole truth, and nothing but the truth?

Mr. DONOHUE. I do.

Mr. EFFROSS. I do.

Ms. LUNDBERG. I do.

Mr. NATIONS. I do.

Mr. ANDREWS. I do.

Chairwoman MORELLA. The record will show that everybody responded affirmatively.

We also try to ask our panelists if they would confine their comments to about five minutes, knowing full well that the full text of any testimony that is submitted will be in the record in toto. You may want to synopsise; may want to change it around, and so proceeding in that regard then it gives us a chance to ask questions. I will start off with Mr. Donohue.

TESTIMONY OF TOM DONOHUE, PRESIDENT AND CEO, U.S. CHAMBER OF COMMERCE, WASHINGTON, DC; ACCOMPANIED BY WALTER A. EFFROSS, PROFESSOR, AMERICAN UNIVERSITY, WASHINGTON SCHOOL OF LAW, WASHINGTON, D.C.; ABBIE LUNDBERG, EDITOR-IN-CHIEF, CIO MAGAZINE, FRAMINGHAM, MA; HOWARD L. NATIONS, LAW OFFICES OF HOWARD L. NATIONS, FORMER VICE PRESIDENT, AMERICAN TRIAL LAWYERS ASSOCIATION, HOUSTON, TX, AND WALTER J. ANDREWS, PARTNER, HEAD OF YEAR 2000 PRACTICE GROUP, WILEY, REIN & FIELDING, WASHINGTON, DC

TESTIMONY OF TOM DONOHUE

Mr. DONOHUE. Madam Chairwoman, Mr. Chairman, ladies and gentlemen of the panel, thank you for inviting us here today to talk about this very unique and very compelling subject.

I would take just a moment to recognize the fact that the Chairwoman and the Chairman and others here and throughout the Congress have taken a very unique and very aggressive approach to this subject. And Mr. Davis and Moran and Mr. Cramer, Mr. Cox, Mr. Dooley, Mr. Dreier, and others have been very aggressive on this matter, and we appreciate their help.

I appear before the committee today in a very unique capacity. I represent whoever will be the claimants and whoever will be the defendants in suits between companies on this issue. You can appreciate how challenging that might be while we are sitting here trying to take a position on these important matters.

Our overriding position is simple: where there has been economic loss, there ought to be an opportunity for people to sue each other to recover damages that have caused problems to their business.

Now, as President and CEO of the Chamber, I spend a large amount of my time visiting and communicating with small and large companies throughout this country. With 3,000 State and local chambers and more than 1,500 associations who are our members, one thing has become abundantly clear: the Y2K problem has business owners and managers extremely concerned. It is broad-based and totally across our economy. It is not one industry. It is not one service. It is not one product. It is universal.

They are facing a serious problem that has the capacity to eat away at the vitality of their business, of the American business system, and of our economy. And the United States clearly is not alone. All around the world, leaders are grappling with the Y2K problem or more importantly, they are not grappling with it and its impact on their economies. If our trading partners abroad are not Y2K compliant in a global economy, U.S. business of every size is at risk. The global implications of this problem are particularly critical and may I say parenthetically the national defense implications in this country and with our friends and adversaries around the world are very serious.

Here and abroad some still cling to the belief that the solution will be an easy one. Somebody will come along with a piece of software and we plug it in and everything will be better. Or, that the easy solution would be to find people that can come and fix it. The problem is we do not know what it is or where it is in many of the longstanding computer programs all over this country and chips in

every type of machinery and activity throughout our society. The reality is very stark and very low-tech. Computer codes, programs, chips, and other fundamental technology underpinnings of our society have to be found and then revised, replaced or rewritten—all of this at tremendous cost. In fact, business has already spent hundreds of billions of dollars and will get up to a number somewhere in the area of a trillion dollars before the turn of the century.

Now, one of the roadblocks, not the only one, to serious correction of this problem is litigation. And that is why the business community and other affected parties are not just faced with fixing the problem. The concern here is simple: it's money, expertise, and the fear of litigation. And the fear of litigation is a very important roadblock standing in the way of Y2K remediation. It is a threat in the terms of runaway litigation costs.

Now, why is that so? And there was an excellent question raised on that. It is because if you are hoping this is not going to be a major problem, why would you go out and alert all of your vendors, all of your suppliers, all of your critics, everybody that wants to sue you that you are dealing with something you really do not understand the answer to. You immediately become liable. And what we need to do here is to look at this as a broad-based societal problem. There are no bad guys in this deal. It is a technological problem of a growing and exciting society. And we need to deal with this in a different way than other issues.

Why do we expect an explosion in litigation? Part of the attraction is the potential to reap huge amounts of money. Willy Sutton robbed banks because that is where the money was. And that is what we are talking about—the greatest opportunity for litigation in recent time. There is an opportunity for unlimited punitive damages and a massive class actions lawsuits that are not going to help anybody.

At a recent ABA convention, a team of lawyers estimated that the amount of legal cost associated with Y2K could exceed all the money spent on asbestos, breast implants, tobacco, and Superfund litigation combined. That is a lot of money.

And at the same time, and it was reported that a participant considered Y2K to be the bug that finally provides the lawyers the opportunity to rule the world. I do not see that. We have a son that just became a lawyer. He has no intention to rule the world.

Now, let me not belabor all of the cost factors that you have already repeated. Let me just say a word that we believe there is a better way to address this problem without falling into a bottomless pit of litigation. The Chamber and the representatives of nearly every sector of American business have, after months of intense negotiation and discussions, rallied behind a fair and reasonable approach to help solve this problem.

Representatives of the Chamber, the National Association of Manufacturers, the National Federation of Independent Business, the National Retail Federation, the American Insurance Association, and others, have come behind this bipartisan legislation introduced by Congressmen Davis and Moran as a reasonable solution to the problem of excessive litigation.

It is important to note, however, that this legislation addresses the problem of wasteful litigation while—and let me say this—pre-

serving the right of plaintiffs to be fully compensated for their Y2K problems. And, yes, the trial lawyers can still earn a lot of money doing that.

What this legislation seeks to avoid, however, is the debilitating effect of unscrupulous individuals and groups trying to exploit this problem. Aggrieved parties should be entitled to full compensation, but not the sort of lottery winnings that we have seen in too many other lawsuits.

Furthermore—and this is important—let me emphasize that this legislation does not affect the claims for personal injury caused by any Y2K failures.

In short, here is what we are talking about: pretrial notice and alternative dispute resolution—common-sense ways to look at this problem; mitigation of damages—the legislation encourages plaintiffs to take steps to fix their Y2K problems before the failures, and plaintiffs would be precluded from receiving damages that could have been easily avoided; proportional liability—defendants would be liable for their proportion of the fault. No more deep pocket issues here. We are looking at reality, not hope. Punitive damage limitations. If you did everything you are supposed to do no punitive damages. If you have not been as astute as you should, limited punitive damages. And attorney fees? We suggest a limit of a \$1,000 an hour. And, Madam Chairwoman, at a \$1,000 and the hours you would work, you would make \$4 million next year without charging any of your staff. You could use it. And small business incentives. Things to do now to help small businesses comply with this problem.

Now, I would like to conclude by saying that unlike other national emergencies that have hit us without warning—storms, like the one we have outside, not quite a national emergency, but in this town, a serious problem. We have an opportunity to address this before it hits. We are forewarned. We are forearmed. And all that we ask is that the Congress, the Administration, and the courts work with the business community to assure that our precious resources are focused on avoiding disruptions and not squandered by unnecessary litigation. We look forward to working with you. But I think it is important to focus on one final issue: we know when this is going to happen. And so to have an effect on it, we need to operate and move ahead now, not six months from now, because we need to set the line in the sand at this time. USA Today had a poll. Sixty-three percent of Americans said that liability ought to be limited on this issue. Today, I am not sure they fully understand the issues, but their instincts are just right.

The question at hand for the Congress is do we wish to fix and avoid this problem, or do we wish to litigate? Thank you very much.

[The statement of Mr. Donohue follows:]

**Statement
on
The Year 2000 Computer Problem and Litigation
to the
United States House of Representatives
Technology Subcommittee of the
Committee on Science
and the
Subcommittee on Government Management, Information and Technology of the
Committee on Government Reform
for the
U.S. Chamber of Commerce
and
U.S. Chamber Institute for Legal Reform
by
Thomas J. Donohue
March 9, 1999**

Introduction

Madam Chairwoman, Chairman Horn and members of the subcommittees, I am Thomas J. Donohue, President and Chief Executive Officer of the United States Chamber of Commerce and Chief Executive Officer of the U.S. Chamber Institute for Legal Reform. The U.S. Chamber is the world's largest business federation, representing more than three million businesses and professional organizations of every size, in every business sector, and in every region of the country. The central mission of the Chamber is zealously representing the interests of its members before Congress, the Administration, the independent agencies of the federal government, and the federal courts. The mission of the Institute for Legal Reform is to reform the nation's state and Federal civil justice systems to make them more predictable, fairer and more efficient while maintaining access to our courts for legitimate lawsuits.

Given the diversity of our membership, the U.S. Chamber of Commerce is well qualified to testify on this important topic. We are particularly cognizant of the problems that small businesses may face as the Year 2000 approaches because more than 96 percent of our members are small businesses with 100 or fewer employees and 71 percent have 10 or fewer employees. I welcome this opportunity to provide testimony on the critical issue of Year 2000 (Y2K) reform and the urgent need for prompt action by Congress.

I would also like to point out that I have unique distinction in that I represent the interests of both potential Y2K plaintiffs and defendants. Certainly under these conditions, you can appreciate the challenge at hand to bring about effective Y2K reform and yet preserve the interests of those whom I represent.

I want to take a moment to recognize the tremendous work of Chairwoman Connie Morella, Chairman Stephen Horn and the rest of the subcommittees on the Y2K issue. This hearing is critical as we all seek to move quickly to address the Y2K problem. I also want to express my appreciation for the leadership and commitment to the Y2K issue by, among others, Representatives Tom Davis, David Dreier, Chris Cox, Jim Moran and Cal Dooley. I also want to thank those of you on the subcommittees that have co-sponsored H.R. 775, the Year 2000 Readiness and Responsibility Act. All of us owe you a great debt of gratitude for your efforts to work with us to address the Y2K problem quickly, fairly and in a bipartisan manner.

During the next year, the world community will face the possibility of a very serious threat to the global economy caused by the transition of computing systems to Y2K compatibility. This is a challenge not only to our technical ingenuity, but also to the

public's faith in our leading technology industries, the American business community, and government in general and our legal system.

And the United States is not alone. All around the world, leaders are grappling with addressing the Y2K problem and its impact on their economies. This is particularly daunting given the U.S. leadership in the global economy and the implications due to our relationship with our trading partners abroad.

The Y2K Problem

The Year 2000 computer problem started decades ago when, in an effort to conserve memory and time as well as to be cost-effective, programmers designed software that recognized only the last two digits of dates. Thus, when "00" is entered for the Year 2000, a computer may process the date as the year 1900. This can cause the computer to produce erroneous data or to stop operating, both of which have far-reaching implications.

No one knows for certain what the scope of the problem may be. However, our economy is critically dependent on the free-flow of information. If this flow is disrupted or halted, our nation's economy could be seriously damaged. Indeed, the Federal Reserve Bank of Philadelphia recently predicted that while the Year 2000 computer problem may boost the gross domestic product in 1999 by 0.1 percent, or \$8 billion, due to the massive influx of resources to fix the problem, in 2000, however, the problem could shrink GDP by 0.3 percent due to Y2K disruptions. In fact, some estimates are that that the Year 2000 computer problem could cost an estimated \$119 billion in lost output between now and 2001.

What will be the final impact of the Y2K problem on our economy is unknown. But we do know that it poses a very real and serious threat.

Business Awareness and Commitment to Solve the Problem

To that end, American businesses have committed hundreds of billions of dollars and the extraordinary intellectual resources of its employees to meet the challenges we face as computer systems make the transition to Year 2000 compatibility. From laboratories to offices to other workplaces throughout the country, businesses are working diligently to ensure that America is prepared to address the challenges of the new millennium with as little disruption as possible to our economy and every day lives. This will be a tough and costly challenge. As you are aware, the Senate Special Committee on the Year 2000 Technology Problem reported last week that progress is being made in making our nation ready for the turn of the century. The Gartner Group, a technology consulting firm, has estimated that software remediation alone will cost between \$300 and \$600 billion. This amount does not include the cost of repairing other factors, such as hardware, end-user software, embedded systems or litigation. According to the Cap Gemini Millennium Index released on November 10, 1998, major Western economies have made progress in addressing the Y2K problem. Year 2000 spending nearly doubled in the six months before the report, and climbed 93 percent from \$256 billion in April to \$494 billion by October. Projected cost estimates for software, hardware and labor expenses increased 20 percent from \$719 billion to \$858 billion. Furthermore, as of November 1, 1998, U.S. firms had expended 61 percent of their estimated Y2K budgets.

While businesses are working diligently, cooperatively and responsibly to meet this challenge, we must still acknowledge and prepare for the likely possibility that some problems may occur. Unfortunately, even under best-case scenarios, we will not be able to find and fix every single Y2K problem. This includes the Federal government as well. In fact, the General Accounting Office (GAO) reported recently that the Federal government is having difficulty in meeting a March 31, 1999 deadline to find, fix and test all of its computer systems. Only 11 departments were given satisfactory progress ratings, seven were making slow progress and seven more were making unsatisfactory progress. The Senate's Special Y2K Committee echoes some of these concerns as well.

But even if we fix most of the computer system problems, the Y2K problem is still expected to cause some disruptions. Some problems will not be fixed because of technical difficulties, some because of not starting soon enough, and some because of indifference.

Concerns about Litigation

The true tragedy, however, is that some problems will not be fixed because of a fear of litigation or the transfer of resources from actually fixing the problem to defending lawsuits. While business is working to fix the problem, there are those in our society who are planning to exploit it. Unless steps are taken soon, we could experience an explosion in litigation. In fact, Giga Information Group, a technology-consulting firm, has estimated that the amount of litigation associated with Y2K will be \$2 to \$3 for every dollar spent actually fixing the problem. If this is allowed to proceed, guess who will bear the cost? It will ultimately be consumers. Obviously, this scenario would be a monumental tragedy for American businesses, workers and consumers.

Business has good reason to be concerned. A report from the Newhouse News Service quoted a participant in the American Bar Association's most recent annual convention as describing Y2K as "the bug that finally provides lawyers the opportunity to rule the world." In addition, at a seminar held at the ABA's convention, a team of lawyers estimated that the amount of legal costs associated with Y2K could exceed all the money spent on asbestos, breast implants, tobacco and Superfund litigation combined.

Clearly, America has a choice. It can adopt a legal environment that encourages the sharing of information, the fixing of the problem, and the fast, fair and predictable resolution of legitimate claims for compensation. Or, it can allow a potential litigation explosion that could be very costly to American consumers. Just think of the impact this would have on our economy, job creation and maintenance, and the average American family. Can we run the risk of quashing those historic years of economic expansion with the lowest unemployment rate in three decades? Madam Chairwoman, Mister Chairman and members of the subcommittees, this is a very real scenario and a very serious challenge that we have before us.

Business' Recommendations

But something can be done. H.R. 775, The Year 2000 Readiness and Responsibility Act, co-sponsored by, among others, several members of the subcommittees, including yourself, Madam Chairwoman, does so. The business community and other organizations have worked with the Congress to fashion legislation that directly addresses the Y2K problem. This bill encourages remediation, precludes exploitive and costly litigation while continuing to allow those with legitimate claims access to our legal system in addition to giving the courts the means to efficiently resolve

Y2K-related disputes. In developing this bill, the coalition was happy to see that all interests were listened to and compromise and concessions from all the participants was required.

The coalition represents a cross-spectrum of various industries and interests. It includes the U.S. Chamber of Commerce, the National Association of Manufacturers, the National Retail Federation, the National Federation of Independent Business, the National Association of Wholesalers and Distributors, the Edison Electric Institute, the American Insurance Association, the International Mass Retail Association, among many others. It is important to note that some members of this coalition represent both potential plaintiffs and defendants in Y2K-related litigation.

Passage of H.R. 775, or one of the other similar bills currently pending elsewhere in the Congress, would accomplish several things. It would encourage remediation and minimize costs, thereby protecting the economy, jobs, taxpayers and consumers. Our national infrastructure and national security would also benefit.

Before turning to the specifics of what H.R. 775 does, it is important for me to emphasize what it will not do. This legislation does not alter the rights of persons who are physically injured or otherwise truly harmed by a Y2K failure. It specifically excludes from its purview claims for personal injury. It allows those who experience harm because of a Y2K problem to have access to the legal system and to be fully compensated for their real losses.

Over the past five years, most large and mid-size American companies have taken steps to address their Y2K problems. The anecdotal reports we are receiving indicate that the computer systems of most of these companies will be Y2K compliant and that during

the next few months most of them will be testing their systems and preparing for January 1, 2000. Much work, however, must still be done—especially in the small business community.

The consensus proposal is supported by large, mid-size and small businesses because it will both help and encourage them to address their Y2K problems. Passage of H.R. 775 or other similar legislation in the remaining months of 1999 would accomplish several things:

- Business and consumers will be encouraged to fix their Y2K problems because they will not be compensated for damages they could reasonably have avoided;
- Businesses will be encouraged to make efforts to fix Y2K problems because those efforts will be made admissible in contract cases and would be an absolute defense in non-personal injury tort actions; and
- Consultants and other solution providers will know that the terms of their contracts will not be altered if Y2K problems occur, so they will have a greater incentive to take on additional Y2K remediation work.

If Y2K problems begin to materialize, H.R. 775 encourages both potential claimants and potential defendants to resolve their disputes without burdening the court system with expensive litigation:

- Before suing, potential plaintiffs will be required to give potential defendants an opportunity to fix the Y2K problem by giving written notice outlining their Y2K problem. The potential defendants would then have 30 days to provide a written response to this notice.

describing what actions they have taken or will take to fix the problem.

If not satisfied with the response, potential plaintiffs may initiate a lawsuit 60 days after the receipt of the potential defendants' response. This provision will accelerate the remediation process if failures occur, eliminating the need for most lawsuits and preventing the diversion of precious time and resources from remediation to litigation.

- The legislation also encourages parties to resolve their Y2K disputes through voluntary alternative dispute resolution mechanisms.

An important aid in discouraging litigation and encouraging settlement is a set of "ground rules" which ensures fairness to both parties and brings some certainty and predictability to the process. It is important to remember that H.R. 775 does not cover claims for personal injury. Some of the essential points of the bill are:

- It ensures that the terms contained in written contracts are fully enforceable except in cases where a court finds that the contract, as a whole, is unenforceable.
- To minimize the "lottery" aspect of litigation surrounding Y2K, the imposition of punitive damages is limited. Any punitive damages that can be assessed against a defendant are limited to the greater of three times actual damages or \$250,000, or for small companies (those with less than 25 employees), to the lesser of three times actual damages or \$250,000.
- In tort actions, each defendant will only be liable for the amount of damage in direct proportion to the defendant's responsibility. This

provision is modeled on the Private Securities Litigation Reform Act of 1995.

If Y2K failures lead to disputes that cannot be resolved without litigation, H.R. 775 provides additional procedural and substantive rules that small and large plaintiffs and defendants in the business community believe are fair and will promote efficiency. This includes expansion of Federal class jurisdiction for Y2K class actions and no strict liability for a Y2K problem.

I must restate that this legislation does not alter a plaintiff's right to recover actual or consequential damages, bring claims for personal injury, nor does it unduly burden a plaintiff's access to the courts. In other words, the ability of any plaintiff to be made whole from losses resulting from a Y2K failure is not altered.

The legislation also reduces the likelihood of frivolous litigation by placing reasonable limits on the fees that attorneys stand to gain from this problem that threatens our national economy and national security. This provision requires an attorney in a Year 2000 action to not earn a contingency fee greater than the lesser of the attorney's hourly billings (not to exceed \$1000 per hour) or an agreed upon percentage of the total recovery (not to exceed one third of the recovery). In addition, this provision requires that the presiding judge in a class action determine, at the outset of the lawsuit, the appropriate hourly rate (not to exceed \$1000 per hour) and the maximum percentage of the recovery (not to exceed one third of the recovery) to be paid in attorneys fees. This provision serves to both fairly compensate an attorney who takes on a meritorious claim while reducing the incentives for frivolous, speculative and exploitive litigation.

Finally, H.R. 775 contains important incentives for small businesses to become Y2K compliant. The legislation contains a partially guaranteed loan program to help provide small businesses that are trying to become Y2K compliant, needed funds to do so. The legislation also limits the ability of governmental agencies to penalize small businesses that, because of a Y2K problem, have difficulty meeting many of the overly burdensome regulatory requirements imposed by the federal government.

Conclusion

Unlike other national emergencies that hit without any warning, we now have an opportunity to directly address the Y2K problem before it hits. The business community is willing to do its part in fixing the Y2K problem, and to compensate those who have suffered legitimate harms. All that we ask is that Congress, the Administration and the courts work with us to ensure that our precious resources are not squandered and that our focus will be on avoiding disruptions. We look forward to working with you, the full Congress, and the Administration to pass a common-sense proposal for Y2K reform.

U.S. Chamber of Commerce



Thomas J. Donohue
President and CEO

Thomas J. Donohue is president and chief executive officer of the U.S. Chamber of Commerce, the world's largest business federation representing three million companies and organizations.

Since assuming his position in September, 1997, Donohue has revitalized the venerable business lobby, attracting thousands of additional large and small companies as members; strengthening relations with state and local chambers; and significantly expanding the organization's policy expertise, lobbying muscle and national profile.

Under Donohue's leadership, a new Institute for Legal Reform has been created to stop the litigation explosion; the Chamber's public policy research affiliate, the National Chamber Foundation, has been reinvigorated; and the Chamber's multimedia efforts have been modernized and refocused through the "cybercasting" of business information and advocacy programs on the World Wide Web.

Donohue's initial efforts have been chronicled prominently in leading national publications. "The Chamber under Donohue will be more aggressive, energetic, and lively than at any time in its history," said *Industry Week* magazine. According to the *Washington Post*, "Nobody has mastered the new Washington game better than Tom Donohue, a tough and wily operator."

Declaring that "business should stop apologizing" for being the one institution in America that really works, Donohue and the Chamber are rallying American companies of all sizes around six major challenges - in addition to the organization's perennial battles against high taxes and onerous regulations.

Addressing the looming worker shortage, countering union leaders, fighting extreme environmentalists, promoting legal reform, advancing free trade, and combating crime and drugs in the workplace are the major themes of the new Chamber agenda. In the words of *Industry Week*, "If anyone has the chutzpah to bring together the Chamber's various interests, it is Thomas J. Donohue."

Prior to his current post, Donohue served for 13 years as the president and chief executive officer of the American Trucking Associations (ATA), the national organization of the trucking industry. During his tenure at ATA, Donohue tripled the organization's revenue base and increased membership by 100%. He was the driving force in making ATA one of the most powerful and vocal lobbies in Washington.

Before heading ATA, Donohue was a group vice president of the U.S. Chamber of Commerce for eight years. Prior to that, he was deputy assistant postmaster general in Washington, D.C.; regional assistant postmaster general in San Francisco and New York City; and vice president of Fairfield University in Fairfield, Connecticut.

Donohue also serves on a number of boards of directors, including: Union Pacific, Marymount University, Sunrise Assisted Living, and the Hudson Institute, one of America's leading futures organizations. In addition, he is a member of the Business Advisory Committee of the Transportation Center at Northwestern University. He is also President of the Center for International Private Enterprise, a program of the National Endowment for Democracy, which is dedicated to the development of market-oriented institutions around the world.

Born in New York City in 1938, Donohue earned a bachelor's degree from St. John's University and a master's degree in business administration from Adelphi University. He also holds honorary doctorate degrees from Adelphi, St. John's, and Marymount Universities.

Tom Donohue and his wife, Liz, live in Potomac, Maryland. They have three sons.

APR 29 1999

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

STAN M. HARRELL
VICE PRESIDENT, FINANCE
AND CHIEF FINANCIAL OFFICER

April 26, 1999

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202/463-5348
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The Honorable Connie Morella
Chairwoman
Subcommittee on Technology
Committee on Science
2319 Rayburn HOB
Washington, D.C. 20515

Dear Chairwoman Morella:

Pursuant to the Rules of the House of Representatives, I am writing to confirm that the U.S. Chamber of Commerce has not received any grant or monies from the federal government on Year 2000 efforts in the last two years.

Should you have any questions, please give me a call at 202/463-5348.

Sincerely,

Stan M. Harrell
Stan M. Harrell

Chairwoman MORELLA. Thank you, Dr. Donohue. We did give you a little extra time, because we knew how passionate you are about the issue, and we are not so rigid that we would not allow a little more.

Mr. DONOHUE. Thank you.

Chairwoman MORELLA. My pleasure. I wanted to recognize two others who have joined our joint subcommittee to see if they wanted to make an opening statement. First of all, Congresswoman Sheila Jackson Lee from Texas.

Ms. JACKSON LEE of Texas. Chairman Morella, let me thank you and be cognizant of the interest of time and make two or three sentences that ask unanimous consent to have my complete statement put into the record.

Chairwoman MORELLA. Indeed, without objection.

Ms. JACKSON LEE of Texas. Let me thank you and Chairman Horn and Ranking Member Barcia and ranking member Turner for your leadership as usual on this very important issue. This is an unusual hearing because we are talking about liability. Let me just indicate as I note very prominent members of the panel and, in fact, you have a constituent of mine, Mr. Howard Nations, who is both a leader in our community, but very knowledgeable on these issues. I look forward to his presentation, but I accept Mr. Donohue's challenge, coming from a district that represents or has a huge constituency of businesses. I would only turn this back, Madam Chairperson, as I conclude to simply say, I am going to accept the challenge that we fix it, because I think these are what these hearings have been all about, and raise the question of whether we should in any way alter our tort laws, because we are presupposing the worse. I believe this country has an obligation for businesses and others alike to fix the Y2K issue and work with the business community to have them fix the Y2K issue and go into the millennium in a more positive way than thinking about what the negative responses will be. With that, Madam Chairperson, let me thank you for your kindness.

Chairwoman MORELLA. Thank you, Congresswoman Jackson Lee, and you have been very attentive to this issue, and we appreciate it. I would now like to recognize the gentleman from across the river from me, Tom Davis from Virginia, for his comments.

Mr. DAVIS of Virginia. Thank you, Ms. Morella, and I appreciate serving on your subcommittee in the last Congress; on Mr. Horn's committee in this Congress; and note that I was a technology executive before I went into county government and came to Congress.

And as usual, my good friend, Ms. Jackson Lee, and I, although we are law school classmates, come at this from little bit different sides, as we look at it.

I want to thank the Chamber and the National Association of Manufacturers working together and the NFIB and a number of other business groups who want this problem fixed. They want to see whatever money they may be able to make over the next few years not channeled into lawsuits, not channeled into litigation, but put into training workers, putting into technological solutions so America can remain competitive on a worldwide basis. That is the point of this, and the legislation that has been introduced in this particular case really is there to get a solution, because we have

notice. We have cure provisions. We have loans to small businesses so they can be able to fix their problem. We do away with joint and several liability. One of the things that Mr. Nations and I will have an exchange in the question and answer is that society has changed markedly since the UCC was put. We are in an information revolution right now, and a lot of the old rules really never contemplated what we are looking at today. And the interconnection of if you can fix your own system, you can test it, but you never know who you may have to interconnect with down the way, and if something goes wrong, under current law, joint and several liability, you can be held liable for the whole thing, just because you have deep pockets, even though you have done nothing wrong. You have invested hundreds of thousands of dollars to fix it. And that is wrong. So we have come up with proportional liability on this. People who are injured will be able to get their full complement of damages. That is not touched at all. But obviously, we are not going to make this the next round of asbestos suits. We are going to put the money where it belongs.

One thing is certain: the incentives that drive our legal system, I believe, are working against our common national interest in solving the Y2K problem quickly. We need to create an environment in which every single business in America, large and small, can confidently conduct Y2K repair work without fearing that their good faith efforts will eventually put them out of business because the excessive cost of litigation. We have companies now afraid to touch these other systems, because they may be caught up and be sued. And if we do not change the rules, we are going to find companies who, through no fault of their own, are sitting there with embedded chip problems, or problems they inherited in acquisitions. And they are going to be unable to find people to come in and fix the problem.

I ask unanimous consent my entire statement be part of the record. And I look forward to hearing from our witnesses.

[The statement of Mr. Davis of Virginia follows:]

**Opening Statement of Representative Tom Davis
Subcommittee on Government Management, Information, and Technology**

**"The Impact of Litigation on Fixing the Year 2000 Problem"
March 9, 1999
2 p.m.**

Thank you, Madame Chairwoman and Mr. Chairman. First, let me commend both Chairwoman Morella and Chairman Horn for holding this hearing on the potential impact of Year 2000 litigation. There have been estimates that put the global cost of Y2K remediation and testing at \$3.6 trillion. What concerns me and many of my colleagues is of that amount, nearly a third will be spent on time-consuming and costly litigation. A staggering one trillion dollars will be spent on lawsuits; money that could otherwise be spent on repairing information systems, reinvesting in industry, investing in research and development, and creating jobs for Americans. This not only imposes costs on businesses, it has a direct impact on consumers who rely on innovative technology and will face increased costs as a result.

Every industry at every layer in our economy is affected by the Y2K issue. With dates being critical across vast numbers of industries, information systems that are noncompliant will disrupt the free flow of information that forms the underpinnings of our nation's economy.

Since 1996, there have been over 50 bipartisan hearings in the Congress examining a wide-ranging array of issues that are directly related to the Y2K challenge that is facing our global economy. We have listened to consumers and to industry, and what we have consistently heard is that small and large businesses are eager to solve the Y2K problem. Yet many are not doing so, primarily because of the fear of liability and lawsuits. The potential for excessive litigation and the negative impact on targeted industries are already diverting precious resources that could otherwise be used to help fix the Y2K problem.

Why should the anticipated rush of litigation at the beginning of the millennium concern us? There is one big reason: the consequences of uncertainty are and will be detrimental to America.

While businesses have poured billions of dollars into fixing and testing information systems and are still doing so, the legal uncertainty of the Y2K problem is causing some businesses to be cautious in the steps they take. And they have good reason to be fearful. The first Y2K lawsuit was filed in the summer of 1997 and there have been 44 other Y2K lawsuits filed across the country since then. While we know that we are going to have problems on January 1, 2000, we do not know to what extent they will disrupt the every day of lives of our citizens.

But one thing is certain. The incentives that drive our legal system are working against our common national interest in solving the Y2K problem quickly. We need to create an environment in which every single business in America—small and large—can confidently conduct Y2K repair work without fearing that their good faith efforts will eventually put them out of business because of the excessive costs of litigation.

So what can Congress do? Congress can create incentives to businesses and individuals to conduct their Y2K repair work now. If we transform the environment to one of certainty, precious business resources will be spent productively on the continued growth that our nation's economy has experienced for the past decade. Solving problems quickly must be the first option; litigation must be the avenue of last resort.

Last year, Congress passed the *Year 2000 Information and Readiness Disclosure Act* (P.L. 105-271), which was the first step towards encouraging companies to share information

regarding their Y2K readiness. But more certainty is needed.

For all of these reasons, I recently introduced H.R. 775, the Year 2000 Readiness and Responsibility Act.

I am leading a bipartisan bill along with Congressman Moran from my neighboring district in Northern Virginia, Congressmen Dreier, Cox, and Dooley from California, and Congressman Cramer from Alabama, that creates a legal framework which will ameliorate Y2K failures quickly. I also want to thank Chairwoman Morella for being a co-sponsor. It creates a notification process mandating a time period in which a potential defendant must acknowledge responsibility for a Y2K failure and perform remediation. In return, a lawsuit cannot be filed until that time period has expired. With the expected onslaught of Y2K lawsuits after January 1st, this process will create a "breathing period" in which problems will be resolved to the benefit of our entire economy. Individuals and businesses will still be entitled to recover full damages resulting from a Y2K failure. But our proposal helps the parties recover compensation sooner and outside of the costly process associated with the courtroom.

This legislation also implements a proportionate liability standard so that a defendant who has a judgment rendered against him or her is only liable for the proportion of harm caused by his faulty conduct. Defendants are also able to introduce evidence that they did take reasonable and good faith steps to resolve the Y2K problem. And it limits punitive damages for the basic reason that punitive damages are meant to discourage future bad behavior, not to provide a windfall to lawyers and plaintiffs. Since the Y2K problem is a unique and one-time event, punitive damages are simply inappropriate.

Another key component of H.R. 775 is that it provides incentives to small businesses to

become Y2K compliant. It allows small businesses to qualify for up to \$50,000 in loans through the Small Business Administration in order to conduct Y2K repair work, and it provides regulatory relief from federal regulatory fines that would be incurred as a result of a first-time Y2K violation.

Let me close by reiterating that we need to work together to ensure that we—legislators, businesses, individuals—are working at a 100% effort to make a smooth transition to the Year 2000. National emergencies usually mean that they are indeed an emergency. They strike without warning and by necessity leave us with little or no time to prepare. But with the Y2K millennium bug, we have a limited opportunity to meet the challenges it presents. I look forward to working in a bipartisan manner to achieve passage of the Year 2000 Readiness and Responsibility Act and am grateful to you, Madame Chairwoman and Mr. Chairman, for holding this hearing to explore the issues inherent to the impact of anticipated litigation on our Year 2000 remediation efforts.

Chairwoman MORELLA. Without objection, so ordered. It is now my pleasure to recognize Professor Effross from American University, Washington College of Law. I notice that you have a splendid testimony that you have submitted, but you also have even submitted an outline. I tell you, that really is, it shows academic prowess. Professor Effross.

TESTIMONY OF WALTER A. EFFROSS

Mr. EFFROSS. Thank you, Chairwoman Morella, Chairman Horn, ladies and gentleman of the panel. I did have a few slides that I brought in addition—a Powerpoint presentation—I am told if I press this button they will come up on cue.

Chairwoman MORELLA. I hope that you notice that this is the one room that is really the high-tech room, and so we have the visual effect as well as being on the Web as we speak. Thank you.

Mr. EFFROSS. It is tempting, particularly after hearing Mr. Donohue and reading his written remarks in which the word exploit appears not exactly in conjunction with lawyers, but reading between the lines, you can find that fairly quickly, to conjure up images of lawyers as pigs and vultures and buzzards and snakes, oh, my. But I think that actually, especially today, on this snowy, cold day, a more appropriate fable or reference involving animals would be what about—or more appropriately insects, the snake—I am sorry, the grasshopper and the ant. A number of companies are, and a number of firms, a number of individuals are way behind where they should be, and they are the grasshoppers who are blithely figuring that winter is never going to come. Meanwhile, there are large number of companies who are trying to do and have done very, very good jobs of keeping themselves in good situations legally. And they are the ants. And lawyers represent both sides. And, in fact, of those 63 percent of the people in USA Today that Mr. Donohue referred to, a number of people who do not think that there ought to be a lot of liability here, some of those may well be consumers who may be hiring their lawyers to defend their interests against manufacturers of software.

So I suggest lawyers are not the evil ones here, but are, in fact, part of the solution. In my first slide, there is a—which way do I point this? Ah—there is a—types of liability, and I do not think that we are really talking about a revolution in law as much as an evolution. All these issues—contract tort, fiduciary duty, intellectual property, securities law, liable, slander and defamation—all those issues are really on the books right now. The Uniform Commercial Code is very well established. These other laws are very well established. One of the things lawyers value most is predictability. I would suggest we think very carefully before starting to change the rules here.

There is a large number of different ways liability suits can be brought, and they are also very clearly interconnected—the causes of action, the different parties involved, just like in some ways the technology involved. But, again, the building blocks, the basic elements of the law, are really well established. An hour ago,—I was returning a call from a reporter who asked me is there such a thing as Y2K law. And I said, I do not really think there is. There will

be a number of Y2K cases, but they are all going to involve existing principles.

And key among those principles will be first issues of timing and causation; and second, issues of duty and standards. Under causation, there is going to be a massive question as to what is proximately caused by the failure of a program to comply with Y2K. When did the damage happen? What should each party have known and when should they have known it? There is a question, as I have detailed in my materials, as to whether, in fact, just because the industry was all producing non-compliance software whether this is, in fact, something courts will just shrug at and say, no claim here, because everyone was doing it. The T.J. Hooper case that I have talked about in my materials suggest that that is, in fact, wrong; that a court can legitimately say, no one should have been putting this software out there to begin with, at least not without warnings.

Computer malpractice. There are issues here about whether, in fact, there is such a thing as computer malpractice, and Congressman Ose has suggested how to increase the number of people who can cure it. I would suggest there may be a number of people who might not want to be seen so quickly as people who are able to cure these, despite the massive amount of money that can be made in the days remaining until the Year 2000 roles in, because they might not want to face up to certain standards of malpractice. It is also fairly late in the day for people to start qualifying themselves as experts. A marathoner I know tells me that if you are in a marathon, and you are starting to get thirsty, it is way too late to drink enough water to finish that race without being dehydrated. I do not know if that is true, not being a marathoner, but I think it is a nice analogy.

Three duties are going to intersect here. There are, as I have detailed in the materials, a substantial set of issues involving the user's duty to inspect the software itself; to not just query the manufacturer, but to set the date ahead on the computer or network and see whether there will, in fact, be a problem, to buy commercially available software, some of it from Symantec Corporation which will allow you diagnose your Y2K compliance of your systems. To go to corporations' Websites and download patches. That is not something you hear a lot about, but if I were advising companies, I would be telling them before you start suing, consider your duty to inspect.

There is, as has been mentioned, the developers duty to disclose, and this is a concern that there may be some hindrance, as I understand it from reports I hear from industry, not a lot of people have really come forth even with the new law in place and have said, well, fellows, I am fessing up. Here is where we are. If I were a lawyer, I am not entirely sure—I mean, if I were counseling these companies, I am not entirely sure I would be telling them make a clean breast of this entire affair.

Finally, there is the directors' and officers' duty to be informed, and if anyone is just waking up to this issue as a director or officer, I think they are essentially in a position of that thirsty marathoner. It is way too late now to discharge your fiduciary responsibilities to your corporation by now deciding it is time to get

started on Y2K. There is going to be an enormous amount of litigation, and I think justifiable litigation saying, shareholders are going to say why did not you get started early? Then there is going to be a whole set of questions of when, given each company's situation and industry and experience of its board members, when was early enough and what should they have done?

In conclusion, I would like to say I have absolutely no idea of what is going to happen as we approach and begin the Year 2000, but whatever happens, I do not think we should forget the untold hours that software engineers and specialists are putting in as we speak to fix these systems; that legislators, such are yourselves, are putting in and devoting to this issue and how best to deal with it; and also to the lawyers, who I think are not necessarily to be seen as a scourge of society, but as an incentive to people to do the right thing. Thank you for the opportunity to appear before you.

[The statement of Mr. Effross follows:]

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Statement of Walter Effross

**Before the U.S. House of Representatives
Committee on Science, Subcommittee on Technology**

March 9, 1999

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Chairwoman Morella, Chairman McHugh, Chairman Horn, and Subcommittee Members,

Thank you for inviting me to participate in today's hearing on liability for the Year 2000 problem. As a law professor, and particularly as the developer of a course on "Computer Law and Drafting" that focuses on the contractual elements of "computer law" and "Internet law," I appreciate the opportunity to discuss with you the legal ramifications of the Y2K situation.

The interplay of Y2K-related liability considerations in some ways parallels the technological difficulty of the underlying software problems. First, just as experts in decades-old computer languages are being called on to correct the programming practices that gave rise to the Y2K problem, so can the legal issues involved be resolved by applying, and in many cases reviewing the history of and policies underlying, traditional concepts of contracts, torts, intellectual property, and fiduciary duty.

Second, just as each vulnerable computer or network may include several different computer languages, programs, and sub-systems, so will the legal actions arising from the Y2K situation meld a variety of established doctrines.

Third, just as the most serious aspects of the Y2K problem arise from the interconnection of many different chips, computers, and networks, so does the Y2K liability issue raise the spectre of overloading the legal system if a sufficient number of legal actions are brought at once. Although as of this afternoon very few Y2K-related decisions appear on the Westlaw database [including Peerless Wall and Window Coverings, Inc. v. Synchronics, Inc., 1998 WL 906452 (W.D.Pa., 11/19/98) (granting a stay of proceedings until the end of 1998)], there are already a number of actions proceeding [see, for example, the cases cited at <<http://www.milberg.com>>, under "Year 2000"], and undoubtedly many more to come.

In this Statement I have attempted to construct a brief roadmap or overview of the various liability issues that may emerge from the Y2K situation. It is not intended to be either a complete or a final treatment of this complex and evolving subject; nor should it be seen as constituting legal advice. I should also say that although I chair the American Bar Association's Subcommittee on Electronic Commerce, these remarks are my own and do not necessarily reflect the opinion of the ABA, any of its Committees or Subcommittees,

American University, or the Washington College of Law. In addition, so far as I am aware, none of these entities receives federal funding which directly supports Y2K-liability research.

Asterisks appear next to those issues that may be central to the application of traditional doctrines in this context. Many of those issues might be decided on a fact-sensitive, case-by-case basis.

At bottom, though, I think that many of these issues involve variants of the same four basic questions:

(1) What did each party know (and when) about potential Y2K problems involving the software at issue and involving software in general?

(2) Should the party, having this knowledge, have acted differently than it did?

(1a) What should each party have known (and when) about potential Y2K problems involving the software at issue and involving software in general?

(2a) If the party had had the knowledge that it should have had, should it have acted differently than it did?

I. Contract Liability

A. Application of Uniform Commercial Code Article 2

This section discusses the application of contract law to the agreements made between the developers, manufacturers, licensors, or vendors (collectively, and loosely, "sellers") of non-Y2K-compliant software and the users, licensees, or buyers (collectively, and loosely, "buyers") of the software.

Article 2 of the Uniform Commercial Code, a model statute which has been adopted by the states in slightly varying forms, governs the "sale" of "goods." Although there persist questions (usually decided on a fact-sensitive, case-by-case basis) about whether software, particularly custom-developed software, is a "good" rather than a "service," and whether Article 2 can be used in the context of a license, rather than a sale, of software, courts have applied Article 2 directly or by analogies to many software situations.

(The National Conference of Commissioners on Uniform State Law is currently drafting a proposed Article 2B, to deal specifically with the licensing of "information" such as software, but that effort has not yet been concluded, much less approved by the states. Successive versions of this draft Article, as well as versions of proposed revisions to Article 2, are available on-line at <<http://www.law.upenn.edu/library/ulc/ulc.htm#ucc2>>)

1. "Course of Dealing" and "Usage of Trade"

Not confined to "sales of goods" situations, however, is the court's general ability to interpret provisions of an agreement in light of the parties' "course of dealing" and "usage of trade." Both of these terms appear in Article 1 of the Uniform Commercial Code, which supplies principles relevant to any agreement that may fall under any Article of the Code.

Under § 1-205(1), "[a] course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis for understanding for interpreting their expressions and other conduct."

Under § 1-205(2), "[a] usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question."

Section 1-205(3) provides that "[a] course of dealing between parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement."

* Litigation will involve whether the "course of dealing" between or among the parties in question and the "usage of trade" in the software industry in general included, at any relevant time, the programming (and warning, or lack of warning) practices that gave rise to the Y2K situation.

2. Duty of "Good Faith"

Section 1-203 of the Uniform Commercial Code provides that "[e]very contract or duty within [the scope of any Article of the Code] imposes an obligation of good faith in its performance or enforcement."

Section 1-201(19) defines "good faith" as "honesty in fact in the conduct or transaction concerned." If the transaction is a sale of goods and thus falls within the scope of Article 2, § 2-103(1)(b) elaborates that in the case of a merchant, "good faith" means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."

* Litigation will involve whether the sale or licensing of non-Y2K-compliant software, and the terms of the relevant agreement, was done in "good faith."

B. Warranties and Their Disclaimer

1. Express Warranties

a. Express Warranties: Creation

Under § 2-313(1)(a) of the Uniform Commercial Code, "[a]ny affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise." That statement could be made in print, radio, or on-line advertisements, in the contract itself, or from a salesperson directly to the buyer.

Under §§ 2-313(1)(b) and (c), express warranties are also made by, respectively, any "description" or any "sample or model" of the goods, so long as such description, sample, or model is part of the "basis of the bargain."

Under § 2-313(2), express warranties are not made by the seller's "affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods." Such "puffery," which might include statements on the order of "This product is worth its weight in gold," or "This product is truly exceptional," could, however, leave the seller open to tort charges of fraud or misrepresentation.

b. Express Warranties: Y2K

* Have sellers of software given express warranties that the programs will be Y2K-compliant?

Of course, "Y2K-compliant" is itself a term subject to different legal definitions. Rather than just put this phrase into an agreement, a careful lawyer might want to define it and carefully indicate each of its parameters. Sample language is available at <<http://www.irm.state.ny.us/yr2000/contract.htm>>, <<http://www.year2000.com/archive/NFwarranty.html>>, and <<http://www.itpolicy.gsa.gov/mks/yr2000/contlang.htm>>

In addition, until recently very few buyers of software looked for, or negotiated, an express warranty of Y2K-compliance. A buyer could claim that there existed an implied warranty, discussed below, of such quality. However, the buyer might also be able to argue that the language of whatever warranties were expressly given included Y2K-compliance as part of the "usage of trade" in the software industry. (See Official Comment 5 to § 2-313: "Of course, all descriptions by merchants must be read against the applicable trade usages with the general rules as to merchantability resolving any doubts.")

c. Express Warranties: Disclaimer

Under § 2-316(1), a seller can disclaim express warranties by words or conduct, but only when "reasonable." Thus, for instance, a seller cannot promise the buyer that the product will be Y2K-compliant, include this warranty on the software box and advertising literature, and then insert a small provision into the agreement to exclude "all warranties,

express or implied."

As Official Comment 1 to this section elaborates, this section "seeks to protect a buyer from unexpected and unbargained language of disclaimer by denying effect to such language when inconsistent with the language of express warranty. . . ."

* Were disclaimers of any express warranties of Y2K-compliance unreasonable?

2. Implied Warranties

a. Warranty of Merchantability: Creation

If the seller of software regularly "deals in goods of the kind or otherwise by [her] occupation holds himself out as having knowledge or skill particular to the practices or [software] involved in the transaction," she falls within the definition of a "merchant" within § 2-104(1) of the Uniform Commercial Code.

Under § 2-314(1), such a merchant automatically gives buyers an implied warrant of merchantability for the software that she sells. Section 2-314(2) states that to be "merchantable," goods must at least "pass without objection in the trade under the contract description" and be "fit for the ordinary purposes for which such goods are used."

b. Warranty of Fitness for Particular Purpose: Creation

Section 2-315 provides that, whether or not the seller is a "merchant," "[w]here the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified. . . an implied warranty that the goods shall be fit for such purpose."

As Official Comment 1 to this section indicates, the circumstances alone, without any specific statement from the buyer to the seller, may give rise to a warranty of merchantability, "if the circumstances are such that the seller has reason to realize that the purpose intended or that the reliance exists."

Official Comment 2 distinguishes between this implied warranty and the implied warranty of merchantability: "A 'particular purpose' differs from the ordinary purpose for which the goods are used in that it envisages a specific use by the buyer which is peculiar to the nature of his business whereas the ordinary purposes for which the goods are used are those envisaged in the concept of merchantability and go to uses which are customarily made of the goods in question. For example, shoes are generally used for the purpose of walking upon ordinary ground, but a seller may know that a particular pair was selected to be used for climbing mountains." Of course, this Comment points out, a contract may

include both types of implied warranties.

c. Creation of Implied Warranties by Course of Dealing and Usage of Trade

Section 2-314 (3) provides that "other implied warranties may arise from course of dealing [between the parties] or usage of trade [in the industry]." Official Comment 11 to this section gives the example of "the obligation to provide pedigree papers to evidence conformity of the animal to the contract in the case of a pedigreed dog or blooded bull."

d. Implied Warranties: Y2K-Compliance

* A "merchant" dealing in software might be seen to have given a Y2K-compliance warranty as part of the implied warranty of merchantability, if courts find that this quality is part of the industry's standard for a software program. The industry, however, will undoubtedly argue that both the industry and consumers expect software to contain some "bugs," and that the Y2K "bug" is no exception. Of course, there are serious differences between "bugs" that may cause small or slightly annoying problems and those that would drastically curtail or effectively end the usefulness of a software program on January 1, 2000.

* Does Y2K-compliance fall within the scope of the implied warranty of fitness for particular purpose? Buyers could argue that, even before the Y2K problem became common knowledge outside the computer industry, sellers should have known that buyers wanted the programs to function after the Year 2000. In fact, some programs, such as those that run entire manufacturing plants or control crucial industrial or financial processes, might be so important that by their nature they signal to the seller that they must work after January 1, 2000.

* Does an implied warranty of Y2K-compliance arise from the "course of dealing" or "usage of trade"? Buyers might claim that they had been led to believe that all of the programs they bought from this particular vendor, or from any vendor, were Y2K-compliant.

e. Implied Warranties: Disclaimer

Under § 2-316(2), to exclude or modify the implied warranty of merchantability a seller's language must mention merchantability and in the case of a writing must be conspicuous; exclusions or modifications of any implied warranty of fitness for a particular purpose must be made by a writing and must be conspicuous. (Under U.C.C. § 1-201(20) a term or clause is "conspicuous" when it is "so written that a reasonable person against whom it is to operate ought to have noticed it." For example, a term in a contract can be rendered "in larger or other contrasting type or color.")

Under § 2-316(3)(e), "an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade."

* Does the course of dealing, course of performance, or usage of trade exclude or modify any implied warranties of Y2K-compliance?

3. Third Party Beneficiaries of Warranties

Section 2-318 of the Uniform Commercial Code provides three different alternatives for states to adopt. As Official Comment 2 to this section explains, these provisions are intended "to give certain beneficiaries the benefit of the same warranty which the buyer received in the contract of sale, thereby freeing any such beneficiaries from any technical rules as to 'privity.'" The expansion of warranty liability is derived from the warranty of merchantability, discussed above.

The first alternative extends the protection of a seller's express or implied warranties to "any natural person who is in the family or household of his buyer or who is a guest in his home" if it is reasonable to expect that person to "use, consume, or be affected by the goods" and if that person is in fact "injured in person" by these goods.

A second, broader alternative omits the requirement that the third party be in the family, household, or home of the buyer. As in the first alternative, a seller would not be able to remove or limit this provision contractually.

A third alternative removes the requirement that the third party be injured "in person." The seller could not contract around this provision with respect to personal injury, but could modify its application with regard to economic injury. Official Comment 3 to § 2-318 indicates that this alternative "follow[s] the trend of modern decisions as indicated by Restatement of Torts 2d § 402A [discussed below] in extending the rule beyond injuries to the person."

* What types of software are "consumer products"? What types of software-related personal injury liability would be encompassed by these provisions?

4. Buyer's Duty to Inspect

The seller may shoulder the responsibility for ensuring that her goods live up to any express or implied warranties, but the buyer cannot afford to sleep on his rights. At various points in the contracting process, the buyer jeopardizes his legal remedies and recourses if he does not inspect the goods.

* Of course, courts will be confronted with the meaning of "inspect" in this context, as well as what a "reasonable inspection" of software constitutes. Is it enough for a buyer to

install the software, set his computer's (or network's) clock ahead to read December 31, 1999, and then observe whether the software still functions as the date changes to January 1, 2000? Should the buyer be running off-the-shelf (see the program, "Norton 2000," available at <<http://www.symantec.com>> or custom-designed diagnostic software on the new program to confirm its Y2K-compliance? Should the buyer visit the Web sites of software manufacturers to download helpful utility software or "patches"?

a. Before Entering the Contract

Under § 2-316(3)(b), "when the buyer before entering into the contract has examined the goods or the sample or model as fully as he has desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him."

However, this is a section not easily resorted to by the buyer. Not only will few buyers examine software "as fully as [they have] desired" before entering into the contract or licensing agreement, but Official Comment 8 to this section adds that "[t]he particular buyer's skill and the normal method of examining goods in the circumstances determine what defects are excluded by the examination."

Furthermore, Official Comment 8 clarifies that the seller can use the "refused to examine" clause only when the seller has made a demand "that the buyer examine the goods fully. The seller by the demand put the buyer on notice that [the buyer] is assuming the risk of defects which the examination ought to reveal."

Finally, this Comment indicates that if the buyer, although making an inspection, indicates that he is relying on the seller's warranties rather than on his examination, the buyer's warranties will be treated by the court as express warranties, and the discussion of disclaimer of express warranties applies.

b. After Taking Possession of the Software

When the buyer has taken possession of the software, § 2-606(1)(b) the Uniform Commercial Code deems him to have "accepted" it if he fails to make an effective rejection after having had "a reasonable opportunity to inspect them."

c. When Rejecting the Contract or Suing for Breach of Warranty

Section 2-605(1)(a) provides that "[t]he buyer's failure to state in connection with rejection [of the contract a particular defect which is ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to

establish breach," where the seller could have fixed the defect if timely notified.

d. Statute of Limitations

As discussed below, because a breach of warranty of Y2K compliance may begin when the buyer should have discovered the problem, failure to inspect the software could ultimately deprive the buyer of his entire cause of action if the statute of limitations has run on it.

C. Impracticability

Under § 2-615, a seller is excused from delivering any or all of the materials promised under contract "if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made"

* Does the Y2K issue fall within the scope of the impracticability provision?

D. Contractual Limitation of Damages and Remedies

1. Liquidated Damages

Under § 2-718(1), a seller of software can insert into a contract or license a provision "liquidating," or fixing, her damages in case she is found to have breached the contract. However, under this subsection, a court can overturn such a provision if the amount of liquidated damages is not "reasonable in light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy."

* What amount of liquidated damages, if any, is "reasonable" in light of potential Y2K situations?

2. Limited Remedies

Under § 2-719(1), the seller may also (or alternately) provide in the contract a "limitation of remedy," for example, that in certain (or all) situations the dissatisfied buyer can only receive his money back or another copy of the program.

However, this provision, too, may give the seller less comfort than it might appear. Section 2-719(2) provides that "[w]here circumstances cause an exclusive or limited remedy to fail of its essential purpose," a court can ignore that contractual provision and resort to the standard sections of the Uniform Commercial Code to calculate and award damages.

As Official Comment 1 to this section elaborates, "where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions" of the Uniform Commercial Code.

Of course, as this same Comment indicates, a limitation of remedy provision can also be stricken as unconscionable. (Although the Code does not define "unconscionability," one court's explanation of the term has been adopted by many others: "Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party." Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C.Cir.1965).

* Doesn't Y2K cause many exclusive or limited remedies to "fail of their essential purpose"?

* In light of Y2K situations, is a limitation of remedy provision unconscionable?

3. Limitations on Consequential Damages

Under § 2-719(3), a seller can limit or exclude consequential damages— that is, under § 2-715, various economic losses suffered by the buyer as well as any injury to any person or property that proximately resulted from the seller's breach of warranty. However, this same section bars any such provision if it is unconscionable.

Moreover, § 2-719(3) provides that if the contract concerns "consumer goods" (that is, under § 9-109, goods "used or bought for use primarily for personal, family, or household purposes") a limitation of the seller's liability for personal injury is *prima facie* unconscionable.

* Is the software at issue a "consumer good" (at least, as regards the plaintiff in question)?

* Is it unconscionable to limit or exclude consequential damages in light of potential Y2K problems?

E. Statute of Limitations

Under § 2-725(1), "[a]n action for breach of any contract for sale must be commenced within four years after the cause of action has accrued." (The parties may contract to shorten this "statute of limitations" to not less than one year, but cannot extend it.)

In turn, § 2-725(2) provides that the cause of action will accrue "when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach."

* When, then, does the breach occur? This same subsection indicates that a breach of warranty occurs when the seller tenders delivery of the goods; yet "where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered."

* What warranties "explicitly extend to future performance" of software?

* Must discovery of non-Y2K-compliance "await the time of performance"?

* Does the buyer have duty to inspect the software?

* When is the time of performance? January 1, 2000?

* When should non-Y2K-compliance have been discovered?

F. Extent of Damages

1. When the Seller Hasn't Delivered the Goods or the Buyer Has Repudiated the Contract

When the seller doesn't deliver the goods or the buyer has repudiated the contract, the buyer can recover under § 2-713 the difference between the market price at the time when the buyer learned of the breach and the contract price. This measure of damages could be quite large in the Y2K context, if a shortage of compliant software and Y2K programmers as January 2000 is approached or begins dramatically raises the "market price [for conforming software] at the time when the buyer learned of the breach," especially as it compares to the original contract price.

Under these conditions, notes Official Comment 3 to this section, "a liberal construction of allowable consequential damages" should be allowed.

The buyer can also recover incidental damages (discussed below).

2. When the Buyer Has Accepted "Nonconforming" Goods

Under § 2-714(1), the buyer who has accepted goods that do not conform to those promised he may recover "the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable."

Section 2-714(2) provides that in this situation "[t]he measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount." [Y2K as "special

circumstances"]

Under § 2-714(3), "[i]n a proper case any incidental and consequential damages under the next section may also be recovered."

3. Consequential Damages

Section 2-715(2) provides that consequential damages resulting from the seller's breach of contract include "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover [i.e., by procuring substitute goods] or otherwise" as well as "injury to person or property proximately resulting from any breach of warranty."

* Does a need for Y2K-compliant software constitute a "general or particular requirement of which the seller at the time of contracting has reason to know"?

* Is it reasonable to require the buyer to buy substitute software or to fix the program itself (or through third parties that it hires)?

* What damages "proximately result" from Y2K?

Official Comment 3 to this section elaborates that "[p]articular needs of the buyer must generally be made known to the seller while general needs must rarely be made known to charge the seller with knowledge." In addition, Official Comment 4 "rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss. Loss may be determined in any manner which is reasonable under the circumstances."

The seller may take some comfort from Official Comment 6, which expands the analysis of "proximate" causation for these purposes: "Where the injury involved follows the use of goods without discovery of the defect causing the damage, the question of 'proximate' cause turns on whether it was reasonable for the buyer to use the goods without such inspection as would have revealed the defects. If it was not reasonable for him to do so, or if he did in fact discover the defect prior to his use, the injury would not proximately result from the breach of warranty."

4. Incidental Damages

Under § 2-715, incidental damages caused by the seller's breach include "expenses reasonably incurred in [the buyer's] inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with [securing replacement goods] and any other reasonable expense incident to the delay or other breach."

5. Generally Does Not Include Punitive Damages

Contract liability, unlike tort liability (discussed below) generally does not include punitive damages.

[This Statement does not detail the related causes of action that may be available to plaintiffs under the federal Magnuson-Moss Act or state consumer protection statutes.]

G. Anticipatory Repudiation

Under § 2-610, if one contracting party gives "anticipatory repudiation," or warning that it will not fulfill its part of the bargain, to the other, and the failure of that performance will "substantially impair the value of the contract to the other," the other party may decide to wait nonetheless for performance or to treat the contract as having been breached and sue for damages or to compel performance. In either case, the other party can stop performing itself.

This provision, as well as related concerns about evidentiary issues, has undoubtedly contributed to the reluctance of contracting parties to indicate to their "trading partners" that they are not, and/or do not expect to be, Y2K-compliant.

II. Tort Liability

Several different tort causes of action might be asserted by users of non-Y2K-compliant software against its developers or third-party "Y2K-remediators," regardless of whether the software or the remediation fell within Article 2 of the Uniform Commercial Code as a transaction for the sale of goods.

Tort damages generally include compensatory damages for personal injury, property damage, and possibly (except for strict liability suits) economic loss.

A. Fraudulent Misrepresentation of Y2K-Compliance

A software-buyer bringing this action would want to be able to prove that: (1) the seller knowingly misrepresented to the buyer that the software was Y2K-compliant; (2) the buyer bought (or licensed, or used) the software in reliance on those misrepresentations; and that (3) the buyer suffered harm as (4) the proximate cause of that reliance.

The Restatement (Second) of Torts § 526 provides that:

A misrepresentation is fraudulent if the maker

- (a) knows or believes that the matter is not as he represents it to be,
- (b) does not have the confidence in the accuracy of his representation that he states or implies, or
- (c) knows that he does not have the basis for his representation that he states or implies.

The Restatement (Second) of Torts § 525 provides that:

One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.

(If the buyer can't show that the seller intended to deceive him, he could try to bring an action for negligent misrepresentation of Y2K-compliance, discussed below, or, if express warranties have not been disclaimed as discussed above, attempt to prove the breach of an express warranty.)

The plaintiff in such a case may sue for at least economic damages, if not actually also harm for personal injury or property damage. Restatement (Second) of Torts § 531 provides that:

One who makes a fraudulent misrepresentation is subject to liability to the persons or class of persons whom he intends or has reason to expect to act or to refrain from action in reliance upon the misrepresentation, for pecuniary loss suffered by them through their justifiable reliance in the type of transaction in which he intends or has reason to expect their conduct to be influenced.

However, its drafters, the American Law Institute, added a specific "Caveat" in which they "expresse[d] no opinion on whether the liability of the maker of a fraudulent representation may extend beyond the rule stated in this Section to other persons or other types of transactions, if reliance upon the representation in acting or in refraining from action may reasonably be foreseen."

B. Negligent Misrepresentation of Y2K-Compliance

Even if the software seller herself believes that the software is Y2K-compliant, she may still be liable for negligent misrepresentation if she did not take reasonable care to verify this, if she didn't express any reservations clearly, or if she didn't have the level of

skill or competence required of a software developer or merchant.

Restatement (Second) of Torts §552 provides that

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

This liability, note the authors of the Restatement, is somewhat less than that for fraudulent misrepresentation, because where the seller has no intent to deceive, "the fault of the maker of the misrepresentation is sufficiently less to justify a narrower responsibility for its consequences."

C. Malpractice/Negligence

A software user could attempt to sue the developer of the software for professional malpractice, which can be regarded as a special form of negligence.

Generally, the elements of negligence are: (1) a legal duty owed by the defendant to conform to a certain standard of conduct to protect others from unreasonable risks; (2) the defendant's breach of this duty; and (3) proximate cause between the breach and (4) resulting actual loss or damage to the interests of the plaintiff. See KEETON ET AL, PROSSER AND KEETON ON TORTS (5th ed. 1984) 163-164; Restatement (Second) of Torts, §§ 281-282.

To date, courts have been reluctant to accept the tort of "computer malpractice" as such. See Triangle Underwriters, Inc. v. Honeywell, Inc., 604 F.2d 737, 746 (2nd Cir.1979)

(rejecting expansion of medical malpractice concept to apply to seller of "turnkey" computer systems); Columbus McKinnon Corp. v. China Semiconductor Co., Ltd., 867 F.Supp. 1173, 1182-83 (W.D.N.Y.1994) (holding, in context of action against manufacture of allegedly defective computer components, that "[t]o lift the theory of malpractice from its narrow origin of personal, professional services to a lay patient or client and apply it to the law of commercial contracts would obfuscate the necessary boundaries in these two areas of law"); Analysts Int'l Corp. v. Recycled Paper Products, Inc., 1987 WL 12917, at * 5 (N.D.Ill.1987) (holding, in suit against computer systems developer determined to have provided "goods" rather than "service," that "when an action for malpractice is product-oriented, a plaintiff cannot sue the professional in tort. . . . This is because the consequences of the malpractice will be exhibited in the product."); Chatlos Systems, Inc. v. Nat'l Cash Register Corp., 479 F.Supp. 738, 741 n.1 (D.N.J.1979) (holding that "[p]laintiff equates the sale and servicing of computer systems with established theories of professional malpractice. Simply because an activity is technically complex and important to the business community does not mean that greater potential liability must attach. In the absence of sound precedential authority, the Court declines the invitation to create a new tort."); RKB Enterprises, Inc. v. Ernst & Young, 582 N.Y.S.2d 814, 816 (App.Div.3d Dept.1992) ("While computers are relatively new equipment of a complex technical nature critically important to business, we decline to create a new tort applicable to the computer industry."); Metpath, Inc. v. IDS Corp., 1991 WL 39617 (Ct.Super.1991), at *1 (holding that "[a]n allegation of negligence against a computer company does not give rise to a new tort of 'computer malpractice.' . . . Rather, such an allegation simply gives rise to a claim of negligence in a business setting which is clearly actionable.")

In Hospital Computer Systems, Inc. v. The Staten Island Hospital, 788 F.Supp. 1351, 1361 (D.N.J.1992), the District of New Jersey held that:

Professionals may be sued for malpractice because the higher standards of care imposed on them by their profession and by state licensing requirements engenders trust in them by clients that is not the norm of the marketplace. When no such higher code of ethics binds a person, such trust is unwarranted. Hence, no duties independent of those created by contract or under ordinary tort principles are imposed on them. [The defendant] has not established, nor could it, that computer consultants meet the requirements necessary under New York law to give them the status of professionals. Accordingly, this Court does not believe that the cause of action for professional negligence would be recognized by New York courts as against computer consultants.

Such a tort could be grounded in Restatement (Second) of Torts § 299A, which provides that:

Unless he represents that he has greater or less skill or knowledge, one

who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities.

Comment b to this section appears to allow the creation of a standard for professional programmers, by elaborating that the section "applies to any person who undertakes to render services to another in the practice of a profession, such as that of physician or surgeon, dentist, pharmacist, oculist, attorney, accountant, or engineer. It applies also to any person who undertakes to render services to others in the practice of a skilled trade, such as that of airplane pilot, precision machinist, electrician, carpenter, blacksmith, or plumber. This Section states the minimum skill and knowledge which the actor undertakes to exercise, and therefore to have."

Under comment g, a court should make allowance for the "type of community" in which the actor carries on his practice: for example,

A country doctor cannot be expected to have the equipment, facilities, experience, knowledge or opportunity to obtain it, afforded him by a large city. . . [t]he standard is . . . that of persons engaged in similar practice in similar localities, considering geographical location, size, and the character of the community in general.

However, the same comment indicates that the varying standard may not be applicable to the software development community:

[s]uch allowance for the type of community is most frequently made in professions or trades where there is a considerable degree of variation in the skill and knowledge possessed by those practicing it in different localities. It has commonly been made in the cases of physicians or surgeons, because of the difference in the medical skill commonly found in different parts of the United States, or in different types of communities. In other professions, such as that of the attorney, such variations either do not exist or are not as significant, and allowance for them has seldom been made. A particular profession may be so uniform, in different localities, as to the skill and knowledge of its members, that the court will not feel required to instruct the jury that it must make such allowance.

Courts have been more willing to adopt an "ordinary standard of care" measure of the duty of computer and software merchants.

E. Products Liability

1. Warranty Liability

The Restatement (Second) of Torts § 402B provides strict tort liability, devoid of contractual defenses, for express warranties:

One engaged in the business of selling chattels [i.e., products] who, by advertising, labels, or otherwise, makes to the public a misrepresentation of a material fact concerning the character or quality of a chattel sold by him is subject to liability for physical harm to a consumer of the chattel caused by justifiable reliance upon the misrepresentation, even though

(a) it is not made fraudulently or negligently, and

(b) the consumer has not bought the chattel from or entered into any contractual relation with the seller.

Clearly, this provision overlaps to some degree with the express warranty provisions of the Uniform Commercial Code, discussed above. The main differences are that the Restatement section requires that the person making the statement be "engaged in the business of selling chattels" as opposed to a one-time seller, and that the statement be "made to the public" rather than just to the individual buyer. In addition, the defendant's liability appears to be restricted to "physical harm to a consumer," which does not necessarily include anyone other than the buyer.

2. Negligence

In *MacPherson v. Buick Motor Co.*, 111 N.E. 1050, 1051 (Ct.App.N.Y.1916), Judge Cardozo allowed an automobile driver injured by the collapse of a wheel to recover damages from the manufacturer of the car, despite the fact that the manufacturer had not itself produced the defective wheel but had only incorporated it into the car. The car manufacturer, held the court, "was not absolved from a duty of inspection because it bought the wheels from a reputable manufacturer. . . . It was responsible for the finished product. It was not at liberty to put the finished product on the market without subjecting the component parts to ordinary and simple tests. . . The obligation to inspect must vary with the nature of the thing to be inspected. The more probable the danger, the greater the need of caution."

A leading treatise on torts has thus described "[t]he rule that has finally emerged[:] that the seller is liable for negligence in the manufacture or sale of any product which may reasonably be expected to be capable of inflicting substantial harm if it is defective." See PROSSER AND KEETON ON TORTS, *supra*, at 683.

The authors continue: "Since the liability is to be based on negligence, the defendant is required to exercise the care of a reasonable person under the circumstances. His negligence may be found over an area quite as broad as his whole activity in preparing and selling the product. He may, for example, be negligent in failing to inspect or test his materials, or the work itself, or the finished product, to discover possible defects, or

dangerous propensities; and in doing so he is held to the standard of an expert in the field. At the other extreme, he must use reasonable care in his methods of advertising and sale, to avoid misrepresentation of the product, and to disclose defects and dangers of which he knows. In between lies the entire process of manufacture and sale." *Id.* at 684 [footnotes omitted]

2. Strict Tort Liability

Restatement (Second) of Torts § 402A provides for strict tort liability, without proof of an express warranty, negligence, and direct relationship to the injured party, and without the defense of contractual disclaimers:

(1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if:

(a) the seller is engaged in the business of selling such a product, and

(b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

(2) The rule stated in Subsection (1) applies although:

(a) the seller has exercised all possible care in the preparation and sale of his product; and

(b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

Courts have justified adopting this approach by reasoning that manufacturers are best able to adjust the risk of defective products, and that this gives them an incentive to do so, in addition to eliminating many of the proof problems that would otherwise plague the plaintiff. PROSSER AND KEETON, *supra*, at 692-93.

Strict liability can be imposed for defective (i.e., unreasonably dangerous) design, defective manufacture, and/or a failure to warn the user.

Of the failure to warn, Prosser and Keeton comment, at 697, that the plaintiff "must, according to the generally accepted view, prove that the manufacturer-designer was negligent. There will be no liability without showing that the defendant designer knew or should have known in the exercise of ordinary care of the risk or hazard about which he failed to warn. Moreover, there will be no liability unless manufacturer failed to take the precautions that a reasonable person would take in presenting the product to the public." Each reseller is also subject to liability for failure to warn, whether or not she was personally negligent.

* Can sellers of non-Y2K-compliant software claim that they did not know of the potentially far-reaching consequences of this "bug"?

Prosser and Keeton observe at 700-701, that:

The scientific inability to avoid occasional flaws in products due to miscarriages in the construction process has never altered the fact that an impure or flawed product is defective if the product proves to be more dangerous than it was intended to be. Therefore, the scientific inability to discover in advance that the harmful side effects of a drug outweigh all its benefits does not alter the fact that, if it proves to do so, it was a bad and defective product. A court may conclude that as a matter of policy in one or the other or both such circumstances scientific inability to detect the risk or hazard justifies excusing the manufacturer. If so, this is simply a recognition of the notion that fault in the sense of negligence should be a prerequisite to discovery. It is generally agreed, however, that inability to prevent flaws from occurring will not excuse, but there is considerable diversity of opinion about inability to discover or appreciate hazards related to the way products are designed and composed.

F. Seller's Defenses

1. Best Practices

Software developers can argue that the year abbreviations that led to the Y2K situation were "state-of-the-art" when they were introduced, and raise questions about when this practice should have been abandoned.

However, at least one notable decision has significantly undercut the "best practices" argument. In *The T.J. Hooper*, 60 F.2d 737, 740 (2nd Cir.1932), cert. denied, 287 U.S. 662, Judge Learned Hand found the owners of tugboats liable for damages suffered to cargo and barges as a direct result of their failure to equip the tugboats with radio receivers to help them learn of weather predictions. It made little difference to the court that the tug industry had generally not adopted such equipment: "[I]n most cases reasonable prudence is in fact common prudence; but strictly it is never its measure; a whole calling may have unduly lagged in the adoption of new and available devices. It may never set its own tests, however persuasive be its usages. Courts must in the end say what is required; there are precautions so imperative that even their universal disregard will not excuse their omission."

b. Causation

As in contract causes of action, defendants in tort cases can raise a host of causation

issues, including that there were "unforeseeable consequences" of defendants' practices, that there was an "unforeseeable plaintiff" who was unusually positioned to suffer harm unforeseeable to the defendant, and that there were unforeseeable "intervening causes."

Of the core issue, that of "proximate causation," Prosser and Keeton observe, at page 263 of their treatise, that "[t]here is perhaps nothing in the entire field of law which has called forth more disagreement, or upon which the opinions are in such a welter of confusion. Nor, despite the manifold attempts which have been made to clarify the subject, is there yet any general agreement as to the best approach."

c. Assumption of the Risk/Contributory Negligence

Software developers could argue that buyers were aware of Y2K risks, either because of express warnings and disclaimers or from other sources, but nonetheless chose to proceed with the transaction—and with use of the software.

* Does the buyer thereby consent to future negligence of the software developer—for instance, the developer's failure to provide software updates, "patches," or "fixes"? As Prosser and Keeton note on page 485, "A pedestrian who walks across a street in the middle of a block, through a stream of traffic travelling at excessive speed, cannot by any stretch of the imagination be found to consent that the drivers shall not use care to watch for him and avoid running him down. On the contrary, he is insisting that they shall."

* Did the buyer fully appreciate the risk of using the software?

* Should the buyer have acted to limit his Y2K risk?

d. Statute of Limitations

Tort actions may be barred by statutes of limitations. In particular, the statute of limitations for negligence causes of action is usually deemed to have begun running when damage occurs or when a plaintiff should reasonably have discovered it.

* Like medical malpractice cases, Y2K cases will raise significant questions of when Y2K-related damage begins to occur, when a plaintiff should have discovered it, and whether a cause of action can be brought before the plaintiff has actually suffered damage.

e. Sovereign Immunity

Governments and their agencies may be immune from Y2K liability under the doctrine of sovereign immunity.

III. Liability of Corporate Officers and Directors

Under the Revised Model Business Corporation Act (adopted in varying forms by different states), directors (§ 8.30) and officers (§ 8.42) of a corporation have a fiduciary duty to the firm and its shareholders to act in good faith, with "the care that an ordinarily prudent person in a like position would exercise under similar circumstances," and in the best interests of the corporation.

The so-called "duty of good faith," "duty of care," and "duty of loyalty" also appear in other state and model statutes governing the managers of other types of business organizations.

A. Duty of Due Care

In the Y2K context, the most dangerous element of fiduciary duty for directors and officers concerned about their personal liability is the "duty of care." Directors and officers have a duty to be informed of developments affecting their industry, and the Y2K situation is certainly one of these. They are allowed to rely on the advice of reasonably-chosen experts, but they do have a duty to investigate and deal with potential problems.

If a corporation's computer systems are non-Y2K-compliant, or even if those of its key trading partners are, and the value of the corporation's shares drop, the shareholders may bring a shareholder derivative lawsuit against the directors and officers personally, claiming that management breached its duty of due care to identify and resolve potential problems.

Key issues in such suits will include:

- * How early should corporate directors and officers have been aware of the Y2K situation?
- * What (depending on the corporation, its industry, and its position within the industry) constituted an appropriate response to potential Y2K problems?
- * Whom could corporations legitimately consult as experts?

B. Corporate Indemnification of Directors and Officers

The law of some states allows shareholders to approve the adoption of a corporate policy of indemnifying directors and officers from personal liability. However, these policies generally have some exclusions, such as for instances in which the directors and

officers were not acting in good faith or with the duty of loyalty.

* Will a corporation's policy indemnifying officers and directors cover situations of failure of due care with respect to Y2K?

IV. Copyright Liability of Intellectual Property Licensees

Licensees of software may find themselves unable to have non-Y2K-compliant software modified by the licensor. They then face the issue of whether they can legitimately turn the software over to a third party to modify it.

Arguably, this would infringe the copyright of the licensor in the software; in fact, many licenses specifically prohibit the user from modifying the software or having it modified, and bar the "reverse engineering" of the software to render it more easily modified. Under 17 U.S.C. § 106, the owner of the copyright has the right to control the reproduction of the software, as well as the preparation of "derivative works," which are defined as "a work based upon one or more preexisting works. . . . A work consisting of . . . modifications which, as a whole, represent an original work of authorship, is a 'derivative work.'" A software program modified to render it Y2K-compliant would likely be found to be a derivative work of the original program.

The licensee might be able to fit within two exceptions to copyright infringement:

A. The "Fair Use" Exception to Infringement

Under 17 U.S.C. § 107, exceptions are made when a work is reproduced, or a derivative work created, "for purposes such as criticism, comment, news reporting, teaching . . . , scholarship, or research." Even if the modification of the work did not fit neatly within these grounds, the licensee might urge a court to evaluate it under the four traditional "fair use" factors: the purpose and character of the copying (whether it was commercial or not); the nature of the copyrighted work; the amount and substantiality of the portion used; and the effect of the copying on the market for or value of the work.

If the licensee did not intend to sell the modified version of the software, a court might be inclined to allow it this measure of self-help.

B. The "Essential Step" Exception to Infringement

Under 17 U.S.C. § 117, the owner of a copy of a work may "make or authorize the making of another copy or adaptation . . . as an essential step in the utilization of the computer program." Arguably, the creation of a modified version of a program would fit

within this exception if the program would not operate correctly as the Year 2000 approached.

V. Liability Under Securities Laws

Business entities and their management may be liable for failure to disclose Y2K problems or expenses, under existing securities laws (especially § 10b of the SEC Act of 1934, and Rule 10b-5, which prohibits an issuer of securities from making misstatements or omissions in connection with the purchase and sale of securities) and under SEC Staff Bulletin No. 5 (October 8, 1997), which required specific disclosure of information related to Y2K compliance.

VI. Liability of Insurance Companies

Among the questions concerning whether existing insurance policies will cover Y2K liabilities are:

- * Do these liabilities fall within typical exclusions to directors' and officers' insurance policies such as: criminal fines and penalties; losses due to fraud, crime, or actions not in the company's best interests; damage to property; personal injury; and emotional distress?
- * Does Y2K constitute a "fortuitous event" that brings business interruption within the coverage of the policy?
- * Is the policy "claims-made" (that is, losses must be claimed during the period of coverage) or "occurrence-based" (that is, losses may be claimed after the coverage period ends, so long as the claims arose within that period)?
- * When do Y2K-related claims "arise"?
- * Does "Errors and Omissions" coverage include Y2K-related claims?
- * Can insurers now specifically exclude Y2K-related claims from coverage?

VII. Libel, Slander, and Defamation Liability

As more and more companies draw up unofficial lists of companies that are reputed to be non-Y2K-compliant and who are thus shunned by others in their industry, there will undoubtedly arise actions for libel, slander, and defamation by companies that have been erroneously characterized (perhaps in an on-line "chat room" or newsgroup) as non-compliant. Actions might even be brought for tortious interference with contract.

Ms. Chairwoman, Mr. Chairmen, and Members of the Subcommittee, this concludes my written Statement. Thank you again for the opportunity to address the

Subcommittee.

I hope that this abbreviated outline is of use to you. I would be happy to respond to any questions that you may have.

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Walter Effross joined the faculty of American University's Washington College of Law in 1995 as an associate professor after practicing commercial and computer law for five years with McCarter & English, New Jersey's largest law firm. He teaches courses in Business Associations, Computer Law and Drafting, Sales and Secured Transactions, Negotiable Instruments, and Corporate Bankruptcy.

An honors graduate of Princeton University, where he won the freshman and sophomore English prizes, Professor Effross attended Harvard Law School and clerked for Justice Daniel J. O'Hern of the Supreme Court of New Jersey. He has served as an adjunct professor at the Seton Hall University School of Law; as a lecturer for the Southwest Bankruptcy Law Institute, the District of Columbia Bar Continuing Legal Education Committee, and the New Jersey Institute for Continuing Legal Education; as a barrister for the New Jersey Bankruptcy Inn of Court; and as a trustee of the New Jersey State Bar Foundation. He was awarded the New Jersey State Bar Association's Service to the Bar Award in 1992 and its Young Lawyer of the Year Award in 1994.

Professor Effross has written law review articles on issues including: the optimal legal construction of commercial Web sites; the regulation of stored-value card and "smart card" payment systems; the legal aspects of "cyberpunk" science fiction; repelling unwelcomed links to a Web site; the threat that electronic "profiling" techniques pose to individual privacy; and electronic forms of drafts, checks, and promissory notes. His most recent article, to be published in February by the Ohio Northern University Law Review, provides a draft uniform privacy policy and a draft "terms and conditions" package for financial institutions' Web sites. In March 1999, he was awarded the Washington College of Law's Emalee C. Godsey Scholar Award.

He is an editor of the *Journal of Electronic Commerce*, the *American Bankruptcy Institute Journal*, *Electronic Money*, and America On-Line's E-Commerce Project; a former editor of the American Bar Association's magazine, *Business Law Today*; and a columnist on Internet law issues for the periodical, *Multimedia and Web Strategist*, on software copyright issues for the *Computer Law Strategist*, and on commercial Web sites for the *Journal of Internet Banking and Commerce*. Professor Effross is the current chair of the American Bar Association's Subcommittee on Electronic Commerce and the chair-elect of the Association of American Law Schools' Section on Commercial and Related Consumer Law, and was the 1997-98 chair of the AALS's Section on Creditors' and Debtors' Rights. He is also a member of a New Jersey State Bar committee organized to prepare a manual on responsibilities of fiduciaries; a contributing author of the treatise, *Collier on Bankruptcy*; and a co-author of the *New Jersey Bankruptcy*

Practice Manual.

In April 1997, Professor Effross organized and moderated an *American University Law Review* Symposium on the Electronic Future of Cash; for March 1999 he has organized and will moderate the *Administrative Law Review* Conference, "Regul@tion\$.gov: Coming to Terms With On-Line Commerce." In June 1998, he testified on electronic commerce before the House Commerce Committee's Subcommittee on Telecommunications, Trade, and Consumer Protection.



AMERICAN UNIVERSITY
WASHINGTON, D.C.

March 13, 1999

Fax (202) 225-0891

Joseph Sullivan, Staff
Subcommittee on Technology
Committee on Science
U.S. House of Representatives

To whom it may concern:

I have not received federal monies regarding the year 2000 issue
("Y2K") within the last two years.

Walter A. Effross
Associate Professor of Law
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Chairwoman MORELLA. Thank you. And thank you for bringing the illustrative slides to accompany your testimony. I am pleased now to hear from Ms. Abbie Lundberg, who is the Editor-in-chief of CIO magazine.

TESTIMONY OF ABBIE LUNDBERG

Ms. LUNDBERG. Madam Chairwoman, Chairman Horn, and members of the subcommittee. My name is Abbie Lundberg, and I am Editor-in-Chief of CIO magazine. CIO is a magazine that goes to chief information officers. These are the executives in companies, mostly large and mid-sized companies, and government—State and local agencies.

These executives are responsible for managing the information technology used in their companies. We write about current trends and present case studies on the effective use of technology, and I am here partly representing my readers and to give you my point of view.

With less than 10 months to go to the Year 2000, our focus should remain on fixing the computer bug and minimizing the impact of whatever problems might occur. As I understand it, the question being posed at this hearing is what effect the threat of liability will have on companies and whether or not companies can reach these critical goals.

In preparing this testimony, I spoke with a number of CIOs at large and mid-sized companies in a variety of industries. One thing these CIOs all agreed on is that no one, absolutely no one, can guarantee that their systems will be 100 percent Y2K compliant. However, everyday, they receive letters from customers, suppliers, and other trading partners asking them to do just that.

As a result, companies have had to spend a tremendous amount of time documenting all the steps they have taken to try to make their systems Y2K compliant. One CIO told me he has a stack of paper 12 inches thick for each system that he has fixed.

While this mountain of paperwork has certainly consumed a lot of time and energy, the CIOs who have been working on this problem for some time do not feel that the threat of liability has impeded their process to get the problem fixed. If anything, it has pushed them to be more rigorous.

For most large companies—and these are the companies that really have the most complex problems to address—we are now nearing the end of this long process. Last month, in a poll at one of our conferences, we asked 214 CIOs how far along they were in fixing their Y2K problem. Eight-five percent said they were 75 percent to 100 percent done, and other surveys mirror these same results. And this was anonymous. They did not have to put their name on it, so there was no incentive to falsely give their answers.

The exception, of course, is with small businesses, many of which are only now facing up to the grim realities of Y2K. Most small businesses do not have a CIO or anyone to lead the Y2K charge. Many of these companies are at a loss of where to begin. Anything the Government can do to mobilize help to these small companies would be well worth the investment of time and resources.

In a CIO magazine poll conducted last October, over 50 percent of 330 respondents thought that the Government should (A), create

a disaster recovery fund to deal with the year 2000 emergencies, and (B), create an emergency management agency like FEMA to coordinate crucial year 2000 planning and response.

Y2K failures will come in many shapes and sizes, and so too will the liability issues. But as one CIO put it, if a company commits to provide goods or services, it is responsible for doing so regardless of whether their employees go out on strike, their trains get lost, or their systems fail due to Y2K. The answer is not to limit liability across the board. The answer is to let the legal system do its job, and decide which cases have merit and which haven't.

The Year 2000 Working Group of the Society for Information Management, a national CIO member organization, drafted a statement that reads in part, "We are concerned that Y2K-related legislation risks reducing the incentives to responsively address Y2K issues and make contingency preparations." Perhaps the extent of this problem is so great that it calls for drastic measures. I don't know. What I do know is that CIOs, the business people who are closest to this problem, do not believe that the threat of liability has impeded the process. On the contrary, it may have acted as a powerful stimulus for giving the problem the serious attention it deserves.

My recommendations are that Government and businesses should one, focus on solving or minimizing the impact of Y2K. Two, provide critical information to small businesses and non-profits about how to fix the problem. Three, continue to encourage information sharing between companies about their own status. Four, take a good-faith posture whenever possible, and allow a reasonable grace period for a company to fix a problem before being sued. Five, consider mediation before litigation. And six, protect consumers and businesses by holding companies responsible for not fixing their Y2K problems.

Thank you for the opportunity to speak to you today, and to represent the viewpoints of CIO's readers.

[The statement of Ms. Lundberg follows:]



CIO COMMUNICATIONS, INC.

Where Technology Gets Down to Business

CIO MAGAZINE

Testimony of

CIO.COM

**ABBIE LUNDBERG
EDITOR-IN-CHIEF
CIO MAGAZINE**

**EXECUTIVE
PROGRAMS**

THE IMPACT OF LITIGATION ON FIXING Y2K

**PARTNERSHIP
PROGRAMS**

**Before The
SCIENCE COMMITTEE'S SUBCOMMITTEE ON TECHNOLOGY
AND THE COMMITTEE ON GOVERNMENT REFORM'S
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION AND TECHNOLOGY
UNITED STATES HOUSE OF REPRESENTATIVES**

Washington, D.C.

March 9, 1999

An IDC Company

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Chairwoman Morella, Chairman Horn and members of the Subcommittees:

My name is Abbie Lundberg, and I am editor in chief of *CIO* magazine. *CIO* is the leading publication for chief information officers and other senior executives who use information technology to improve their business. We provide current trend information and case studies on the effective use of technology. Our readers work in major corporations—mainly Fortune 1000—and in federal, state and local government agencies nationwide. Personally, I have ten plus years of experience covering technology-related business issues, and I am an advocate for the effective use of technology to further organizations' goals.

Relative to this hearing, my stated expertise is on the Year 2000 and the role of the chief information officer, or CIO. The subject of my testimony is "The Impact of Litigation on Fixing Y2K."

First, I'd like to tell you what I believe about Y2K: There will be many problems arising from the computer date failure. Some of these will be serious; many more will be of relatively minor significance. However, because the many pieces of our national and global economies are so interdependent, so networked, a single failure in the supply chain of a business can cause a domino effect.

The example of potential air travel failure is a good illustration. The problem is not that planes are going to fall out of the sky. The real problem is that the systems that manage reservations, fly the airplanes, run the airport, handle baggage, control air traffic and monitor airport security are controlled by many different entities. All are susceptible to Y2K failure; failure by any one could hold up flights. At the same time, a failure at Dulles here in Washington will cause problems at Logan in Boston. Finally, if the small to mid-sized suppliers to any of these entities (or the suppliers of their suppliers) fail to address their own problems, even if things work fine on January 1st, we will surely encounter problems in the weeks and months that follow.

No one knows what will actually happen at the turn of the millennium. But with less than ten months to go, our focus should remain on fixing the problem and minimizing the impact of whatever failures might occur. As I understand it, the question being posed at this hearing is what effect the threat of liability has on companies' ability to achieve these critical goals.

HOW DO LIABILITY ISSUES IMPACT A COMPANY'S ABILITY TO FIX THE Y2K PROBLEM?

In preparing this testimony, I spoke with a number of chief information officers at large and mid-size companies in a variety of industries, including financial services, construction, hospitality, manufacturing and non-profit. One thing these CIOs all agreed on is that no one—absolutely no one—can guarantee that their systems will be 100 percent Y2K compliant. However, every day they receive letters from customers, suppliers and other trading partners asking them to do just that.

As a result, companies have had to spend a tremendous amount of time documenting all the steps they have taken and continue to take in making sure their systems will be ready. One CIO told me he has a stack of paper 12 inches thick for each application he has fixed.

While this mountain of paperwork has certainly consumed a lot of time and energy, the CIOs who have been working on this problem for some time do not feel that the threat of liability has slowed the compliance process. One said that while the level of



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documentation has been excessive, if a company is to do systems repair and testing right, its people should document the steps they go through anyway.

Another point to consider in this issue is that for most companies, we are now nearing the end of this long process. They have been remediating and testing and documenting this work for years now. Last month, in a poll at one of our conferences, we asked CIOs and other key business executives how far along they were in fixing their companies' Y2K problem. Eighty-five percent of 214 respondents said they were 75% to 100% done. If the goal in limiting liability is to free organizations from having to devote time and energy to documentation, then—at least for most medium and large companies—the proposed legislation comes too late.

The exception, of course, is with small companies, many of which are only now facing up to the grim realities of Y2K. Most small businesses do not have CIOs or anyone to lead the Y2K charge, and they're at a loss where to begin. The CIO of a large, well-funded non-profit has his remediation well in hand, but he expressed concern for his smaller brethren, many of whom supply critical services such as delivering food to the elderly. These smaller non-profits have not yet begun to address the problem, and they need help. Having to worry about the paper chase is the last thing they need. Small hospitals and utilities are in the same boat. Anything the government can do to mobilize help to these small companies would be well worth the resources. In addition to providing funding to small businesses, perhaps the government could provide other forms of emergency response such as guidelines, how-to frameworks and even human resources.

Our readers also support government involvement in helping companies and communities cope with problems from Y2K: In a *CIO* magazine poll conducted last October, 54% of 330 respondents thought the government should create a disaster recovery fund to deal with Year 2000 emergencies. When asked if the government should create an emergency management agency like FEMA to coordinate and provide leadership for crucial Year 2000 planning and response, the majority (53%) also said yes.

SHOULD COMPANIES BE HELD ACCOUNTABLE FOR Y2K-RELATED FAILURES?

Y2K failures will come in many shapes and sizes. So too will the liability issues. I'll ask you to consider a few hypothetical examples:

- Should technology vendors who were still shipping products that were not Y2K compliant as late as last year be held accountable to unwitting consumers and small businesspeople?
- Should a systems integrator who installed a multimillion-dollar system four or five years ago assume responsibility for making that system Y2K compliant? What if the system was sold on the basis that it would show a return on investment in five to 10 years, and Y2K now puts that ROI in jeopardy?
- What about a supplier whose inability to deliver parts cripples a manufacturing company?
- Or a traveler who is robbed or injured because the electronic door lock in his/her hotel room fails?

As one CIO put it, if a company commits to provide goods or services, it is responsible for doing so, regardless of whether its employees strike, its trains get lost or its systems fail due to Y2K.



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Many companies are already anticipating the fallout. In the October poll I cited earlier, 55% of respondents said their companies were either setting aside cash reserves for possible lawsuits and product recall problems or should do so.

Yes, the courts may well be clogged with legal action, and yes, this may well have a chilling effect on the economy until things get sorted out. But people and corporations must be held accountable for these failures *if* they are the result of negligence or neglect. The answer is not to limit liability across the board; the answer is to let the legal system do its job and decide which cases have merit and which haven't.

The Year 2000 Working Group of the Society for Information Management, a national CIO member organization, has drafted a position statement on this issue adopting this stance:

"The Y2K problem is a complex set of interrelated problems and we do not believe that there is any legislation that can provide a simple solution or a quick fix. We are concerned that most Y2K-related legislation could present significant risks of reducing the incentives to responsibly address Y2K issues and make contingency preparations. Any legislation that contributes to the Y2K solution should be fair to all parties while preserving existing rights and contractual relationships."

RECOMMENDATIONS

I also believe that businesses should be held accountable. Serious problems arising out of negligence should be able to be prosecuted to the full extent of the law. However, the many minor inconveniences we are sure to encounter should not be allowed to clog up the courts. But is this really something that can be legislated? Or is it the purview of the courts to decide?

Perhaps the extent of this problem is so great that it calls for such drastic measures. I don't know. What I do know is that CIOs—the business people who know the most about this issue—do not believe that the threat of liability has impeded their ability to fix the problem; on the contrary, it may have acted as a powerful stimulus for giving the problem the serious attention it deserves.

I would like to say that I most definitely agree with an underlying assumption of this inquiry: That we should focus first and foremost on fixing this problem, particularly in the many small businesses on which so much of our commerce depends. Government and businesses should:

- Focus on solving or minimizing the impact of Y2K;
- Continue to encourage information sharing between companies;
- Take a good faith posture whenever possible, and allow a reasonable grace period in which a company will have the opportunity to fix a problem before being sued;
- Consider mediation before litigation;
- Protect consumers and businesses by holding companies responsible for not fixing their Y2K problems.

I'd like to thank you for giving me the opportunity to speak to you today, and to present the viewpoints of *CIO's* readers.

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CIO COMMUNICATIONS, INC.

ABBIE LUNDBERG, EDITOR-IN-CHIEF, CIO MAGAZINE

Abbie Lundberg has been following and reporting on information technology management issues and trends for more than a decade. A veteran IT industry observer, she joined CIO Magazine in 1988.

Lundberg is a leading expert on the major technology and business issues facing the business world today and is frequently quoted by leading US media outlets, including The New York Times, CNN, USA Today and Investor's Business Daily. Further, in its 1998 annual media issue, MC magazine (formerly known as Marketing Computers) named Lundberg a Top Journalist, an "Influencer" and one of four in the industry to watch.

Lundberg is a guest speaker and moderator at industry conferences, including CIO Communications' series of executive programs. She also serves as a judge for the Jesse H. Neal Awards, produced by the American Business Press, and the annual Enterprise Value Awards, produced by CIO Magazine. She is a member of the American Business Press and the Computer Press Association.

Areas of Expertise:

Year 2000.

The role of the CIO.

The CEO/CIO Relationship.

Use of information technology for business process transformation.

Return on investment (ROI) from technology purchases.

Knowledge Management.

CIO COMMUNICATIONS, INC.
Framingham, MA March 8, 1999.

Chairman CONSTANCE A. MORELLA,
Subcommittee on Technology, House of Representatives
Washington, DC.

DEAR CHAIRWOMAN MORELLA; This letter serves as confirmation that neither I nor CIO Communications, Inc. (published as CIO Magazine) has received any Y2K-related Federal grants, contracts or monies during the current and the two preceding fiscal years.

Sincerely,

ABBIE LUNBERG, *Editor in Chief*.

Chairwoman MORELLA. Thank you for your testimony, Ms. Lundberg.

I wanted to acknowledge the fact that Mr. Wiener from New York has joined us.

I now turn to Mr. Howard Nations, for his testimony.

TESTIMONY OF HOWARD L. NATIONS

Mr. NATIONS. Madam Chairwoman, Mr. Chairman, distinguished members of the panel, thank you for the opportunity to address you on this most important issue.

There is no need for federal legislation regarding Y2K liability because the common law, the state statutes, and particularly the Uniform Commercial Code, which is in fact the law in all 50 states, provides the remedies and the methods that we need to measure the conduct of businesses, just as it applies in all other business situations. It also should apply to create an impetus to the persons who are now worried about Y2K who are not Y2K compliant to become so.

The laws that we follow, the uniform laws that we have in this country through the 50 states, primarily the Uniform Commercial Code, provide not only rights, but remedies. They have rules for businesses to follow. A number of businesses in this country have followed those rules. Happily, a very large number of businesses in this country have followed those rules. They have become Y2K compliant or they have made vast efforts to become Y2K compliant.

They followed the business judgement rule, they followed the duty of due care, which is what is expected of directors. They are entitled to the remedies that are provided under the Uniform Commercial Code when they now find that as a result of being—despite being internally fined with Y2K, that they now are still having difficulties because of vendors with whom they do business. So they are entitled to rely upon those remedies which have always been there under the UCC. To take away those remedies that are available to the responsible business people who have already addressed this problem, who have addressed it under existing laws, would be unfair.

We have the business judgement rule, the duty of due care, the UCC, the concept of joint and several liability, and class actions, which are working very effectively. Those are business litigation, business-solving rules. They have developed very carefully. They have been finely honed over the past decades. They are the law in all 50 states. I urge that there is no need to change those rules at this late date.

I would like to address another issue. One is that Mr. Donohue said that we know when Y2K is coming. We have also known when Y2K was coming for the last 40 years. The first report on this was written by Robert Berner and published in 1960. There have been frequent reports of this ever since 1960. So this is no great surprise.

The Senate Committee on the Year 2000 Technical Problem has, as I quoted in my paper, said that the problem here is a problem of leadership. That corporate leaders have not focused on this problem because it is easier to focus on market share and profits. Fortunately, most of our responsible business leaders have focused on the problem. The result is that what we have now is not a computer glitch problem. This is a crisis of leadership. Now we are trying to turn it into a crisis of corporate accountability.

I respectfully submit that the best way to—one way to approach this is to have legislation that would aid in remediation. I suggest that a federal repository for Y2K remediation solutions which could be used across industries be established. In order to get people to put their solutions into that repository, we could possibly offer a tax incentive for doing so.

The problem is that there are 500 computer languages, 500 different languages that we are having to deal with, and there are 36 million programs. A lot of the companies that are using the same language, are working on solutions separately. If we could provide a tax incentive to people, to businesses once they find a solution to put it into a federal repository, possibly a tax solution, based upon the number of other companies that used that solution, then that might be an incentive to help out other companies.

The other would be to suspend—there is a rather—there is a rule under the Internal Revenue Code, which I am sure has some good purpose but is certainly is a hindrance in Y2K, and that is under section 482 of the Internal Revenue Code, which says that if you have a division in Michigan, for example, that creates a solution in a large corporation, and then you have another division in California and another one in Florida, and they send that solution out to be used in California and be used in a different division of their

company in Florida, that the receipt of that division, of that solution is a taxable event to the other divisions.

So if it cost \$1 million to create that in Michigan and they receive it in Florida and California, it is \$1 million taxable event for each of them. So even within their own large companies, corporations are not able to swap solutions because of 482.

I also suggest that there should be a suspension of the anti-trust laws in vertical planes, such as the Ma Bell and the baby Bells. Right now it is a violation of anti-trust laws for them to exchange information and to exchange the solutions. I think that law should be suspended in order to encourage them to change solutions—to exchange solutions. And again, their incentive for doing so may be a tax incentive, if the Government could give a tax incentive for doing so. Those solutions could be put into the federal repository I talked about.

Finally, with respect to tax relief, allow the option to amortize the cost of Y2K or to expense it. Right now, Y2K expenses have to be expensed in the same year. A lot of businesses are finding that their expenses are running far more deductions than they need this year. If you allowed the opportunity to amortize, that would be helpful.

Finally, there is one—the relief to governmental agencies. We all have to be concerned about three things. One is the infrastructure, which is provided by the Government and the utilities and so forth. The other is your own internal repairs. The other is the external disruptions.

There is concern about the infrastructure because governments at every level, from the Federal Government on down, are about to take a double hit. The first is obviously the cost of remediation of the governmental agency itself. The Federal Government, as I understand it, is spending \$10 billion. But also, if the impact upon business occurs, there will be less taxes generated. So governmental agencies are going to be collecting less money on one side, and spending more money to remediate Y2K on the other. That could at the lower levels cause damages to the infrastructures of small towns, cities and so forth.

So those are some of the thoughts that I had. In my paper, I also put one last suggestion, which is to adopt a standard definition for Y2K compliance. Because right now, it is a term that is tossed around rather loosely. “Are you Y2K compliant?” “Yes.” Well, that can end up in big litigation if you find out that people don’t have the same definition of Y2K compliance. I have suggested one in the paper. Thank you.

[The statement of Mr. Nations follows:]

U. S. House of Representatives
The Science Committee's
Subcommittee on Technology
and the
Government Reform's Subcommittee
on Government Management, Information and Technology

Hearing

"The Impact of Litigation on Fixing Y2K"

Presented by:
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March 9, 1999

Synopsis of the Testimony of Howard L. Nations
U. S. House of Representatives, The Science Committee's Subcommittee on Technology and the
Government Reform's Subcommittee on Government Management, Information and Technology

The inquiry which we are asked to address is how the potential of liability will affect an entity's ability to timely repair and remediate its year 2000 problems.

Examination of the rules of business law, by which the conduct of business entities is measured, reveals that the law, as it exists in all fifty states, encourages business leaders to immediately address their Y2K problems. Business leaders are held to a standard to make honest, informed, good faith efforts to seek immediate Y2K solutions in order to avoid causing damage, both to their own company and to those with whom they do business. Through avoiding the causation of Y2K damage, entities can avoid liability.

There is no need for federal legislation regarding Y2K liability because the common law principles, state statutes and the Uniform Commercial Code, which has been passed by the legislatures of all fifty states, provide all of the business rules and guidelines needed to measure the conduct of business entities, provide motivation for immediate remedial action, and provide remedies for wrongdoing. The business law in question provides both rules and remedies. Responsible business leaders and consumers who have followed these business rules in matters relating to Y2K are now entitled to rely upon the remedies which business law provides in order to recover from those who ignore the rules and cause damage. It is inherently unfair to change the Y2K rules with two minutes left in the fourth quarter in order to alter the outcome to the detriment of those who have acted responsibly, and followed the rules but will be damaged because of the failure of others to act reasonably.

Distinguished House members, thank you for the opportunity to address your committees on this very important issue. The inquiry which we are asked to address is how the potential of liability will affect an entity's ability to timely repair and remediate its year 2000 problems.

Examination of the rules of business law, by which the conduct of business entities is measured, reveals that the law, as it exists in all fifty states, encourages business leaders to immediately address their Y2K problems. Business leaders are held to a standard to take honest, informed, good faith efforts to seek immediate Y2K solutions in order to avoid causing damage, both to their own company and to those with whom they do business. Through avoiding the causation of Y2K damage, entities can avoid liability. It seems reasonable to assume that the desire to avoid causing damage and the fear of liability arising from such damage should provide sufficient motivation to reasonable business leaders to immediately address Y2K solutions.

America's time honored common law principles and the statutory laws of all fifty states have been promulgated by the best legal minds of the past two centuries, carefully honed in court on a case by case basis, applied in jury trials with sworn testimony and rules of evidence, fine tuned by trial judges and honed into strong legal principles by the appellate courts of this land. The resulting business principles which have emerged from the cauldron of American justice are time tested and tempered and should be applied to resolve the business problems arising out of Y2K just as they have been applied to business problems in America since its inception.

There is no need for federal legislation regarding Y2K liability because the common law principles, state statutes and the Uniform Commercial Code, which has been passed by the legislatures of all fifty states, provide all of the business rules and guidelines needed to measure the conduct of business entities, provide motivation for immediate remedial action, and provide remedies for wrongdoing. The business law in question provides both rules and remedies. Responsible business leaders and consumers who have followed these business rules in matters relating to Y2K are now entitled to rely upon the remedies which business law provides in order to recover from those who ignore the rules and cause damage. It is inherently unfair to change the Y2K rules with two minutes left in the fourth quarter in order to alter the outcome to the detriment of those who have acted responsibly, and followed the rules but will be damaged

because of the failure of others to act reasonably.

To focus on the issue of how liability will affect an entity's ability to fix its Y2K problems, we need only understand the function of the business judgment rule, the duty of due care, the Uniform Commercial Code, and the concept of joint and several liability which have controlled business transactions of this type for several decades.

The directors of a corporation owe a fiduciary duty of care to the corporation and its shareholders in carrying out their managerial roles. That is, they must exercise the same degree of care and prudence that ordinary persons in a like position under the same or similar circumstances would use.

The business judgment rule requires that business persons take informed, honest, good faith actions in the best interest of the company which they presume to lead. Corporate directors who investigate, evaluate, deliberate and document as required by the business judgment rule and the duty of due care will be immunized in their efforts to remediate their Y2K problems. Absent an abuse of discretion, the judgment of directors in making a business decision will be respected by the courts. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). This does not seem to be an unduly harsh burden to place upon corporate directors. These rules certainly should motivate officers and directors to act promptly and reasonably to remedy Y2K problems.

Federal legislation in this area of business law is unnecessary because the Uniform Commercial Code has been adopted by the legislatures of all fifty states, thus providing uniformity to Y2K business law. Under the terms of the Uniform Commercial Code the manufacturers of the defective systems and devices which are at the base of the Y2K problem are subject to liability for breach of implied warranty of fitness for a particular purpose, implied warranty of merchantability, express warranties, and breach of contract. The Uniform Commercial Code was originally formulated through the joint efforts of the best business law minds in the country. The UCC has been effective enough to gain the confidence of fifty state legislatures and the rules, once adopted, have been finely honed by appellate courts over the past three decades. The rules of the UCC have also been taught in business schools and used in business practice over the past three decades. Y2K presents precisely the type of legal disputes

which the UCC was designed to resolve. Most of the Y2K business litigation will hinge on breaches of implied warranties or written contracts. The UCC implied warranties rules should provide a great impetus to business leaders to make every effort to become Y2K compliant before damage occurs.

Additionally, party who reasonably fears that the other party will not be able to perform is given protection by the U.C.C. in that the party may demand assurances that performance will be forthcoming at the proper time. If these assurances are not received within a reasonable time, the party seeking assurances can treat the contract as repudiated and suspend its performance. Thus, the U.C.C. clearly provides adequate remedies for buyers and sellers of all goods, including any good covered by proposed Y2K legislation. To remove the provisions of the UCC from the law controlling Y2K can only serve to remove motivation for timely compliance of those who have already procrastinated in addressing Y2K solutions.

In light of such protections which currently exist in the laws of all fifty states, liability will attach only to those corporate officers and directors who fail or refuse to act with due care and do not follow the business judgment rule. Hence it is incredibly disingenuous for a business leader to claim the inability to repair Y2K problems because such repair may, in some mysterious way, predicate liability. It is respectfully submitted that these business leaders should be concentrating on limiting the damage which they are about to cause instead of seeking limitations on the damages which they fear they will have to pay. The best way to avoid paying damages is not to cause damage. This can be accomplished by focusing, in the limited time remaining, on the remediation process, which they should have undertaken years ago.

Currently, the law in most states provides for joint and several liability of parties in the chain of distribution of a defective product, with the accompanying right of indemnification of downstream defendants by upstream parties until the costs of the damage is ultimately placed on the original tortfeasor. There are sound business and legal principles which predicated the development of this rule and its acceptance by the courts. There has seldom been a greater need in American jurisprudence for maintaining the rules of joint and several liability than in the Y2K litigation field. The reason is that many of the defective products and business systems in

America are manufactured by foreign vendors. As reported in the Senate Year 2000 Committee Report, there is grave concern about the level of Y2K remediation outside of the United States and among many of our most frequent trading partners:

The Committee is greatly concerned about the international Y2K picture . . . Several U.S. trading partners are severely behind in their Y2K remediation efforts. S. Pt. No. 105-106-10 at 6 (1999).

The biggest Y2K impact may occur internationally. While the U.S. should have started its Y2K preparations earlier, worldwide preparations generally lag even further behind. S. Pt. No. 105-106-10 at 1 (1999).

If small business and consumers are left with only several liability against foreign vendors, there will be no remedy and the loss will be absorbed completely by the American consumers and businesses. Many of the products which are marketed in the United States are sold f.o.b. at the dock in the shipping country, e.g., f.o.b. Yokohama. Joint and several liability permits recovery by the end user from the seller in the United States and a cause of action by the seller against the foreign manufacturer. The U. S. distributor will be contracting directly with the foreign vendor and will generally contract for venue in American courts to resolve disputes, with local state law applying to the dispute. Contracts should also contain provisions for submission to the U. S. courts by the foreign vendors for dispute resolution. End users have no such contracts and the abolition of joint and several liability will leave many American consumers and businesses without a remedy for Y2K damage done to them by foreign vendors.

The Y2K problem confronting responsible business leaders in America who have followed the U.C.C. and sound business rules is that they are now facing losses generated by non-compliant vendors, many of whom are foreign.

Possibly, examination of the application of existing laws to real life Y2K situations will serve to illustrate how effectively current law functions in the Y2K world and why there is no need to reject the U.C.C. and change the law.

As of today, March 9, 1999, there have been fifty-six law suits related to Y2K filed in the United States. Many of those cases have been consolidated into class actions so that the total number of actual lawsuits is closer to thirty. Most of the lawsuits are class actions by small

businessmen or consumers against vendors who are seeking excessive prices for Y2K upgrades on products which should have been Y2K compliant at the time they were sold. For example, Dr. Robert Courtney is an OB/GYN solo-practitioner in New Jersey. In 1987, Dr. Courtney purchased a computer medical system from Medical Manager, Inc. for tracking surgery, scheduling due dates and billing. In 1996, the computer crashed from lack of sufficient memory. At that time, Dr. Courtney replaced his old system with a new state of the art Pentium system from Medical Manager for \$13,000, a sizeable investment for a small town solo-practitioner. The salesman assured Dr. Courtney that the new computer system would last at least ten years. One year later, Dr. Courtney received a letter from Medical Manager telling him that the system which he had purchased was not Y2K compliant and it would not be useful to him as of January 1, 1999. In order to solve the Y2K problem which Medical Manager had built into their 1996 model system, Dr. Courtney would have to pay an additional \$25,000 for an upgrade.

- After the company ignored Dr. Courtney's request for a free upgrade of his 1996 system, he retained an attorney and sued Medical Manager seeking to have them either repair or replace his computer system at their cost. Dr. Courtney was designated as a class representative and it developed that Medical Manager had 17,000 other small businessmen-medical practitioners from whom they were demanding \$25,000 for Y2K upgrades. Not surprisingly, within two months after filing the class action Medical Manager offered to settle by providing all 17,000 customers who bought a non-Y2K-compliant system after 1990 with a free "patch" that would make their old systems Y2K compliant. The sudden appearance of the software "patch" rendered it unnecessary for 17,000 doctors to buy a new upgraded system at the cost of \$25,000 each. Application of current law not only saved \$425,000,000 in unnecessary costs to small businesses but also avoided \$425,000,000 in profiteering by Medical Manager through the sale of unnecessary Y2K upgrade systems when a software patch was obviously always available.

This is typical of the type of profiteering which currently confronts small businesses, even prior to January 1, 2000. Small businesses will be a large segment of the plaintiffs in Y2K litigation. For many small businesses, an outlay of \$25,000 or a delay of ninety days during which they are out of business as a result of a non-Y2K-compliant product will be fatal to the

business and lead to bankruptcy. This will be particularly true if the damages which they can recover from the provider of the non-Y2K-compliant device or product are limited. Courtney is an excellent example of how well the current civil justice system works. Within sixty days of filing the lawsuit, the profiteering by the defendant ceased, the demand for \$25,000 from 17,000 small businessmen was withdrawn and shortly thereafter, a free patch was distributed to 17,000 doctors which magically made their old systems Y2K compliant.

Another type of damage which will arise out of Y2K will be the result of negligence by the creators of the system software or programmers of the embedded chips. It is possible that we have seen a preview of coming attractions in New Zealand. At 12:01 a.m. on February 29, 1996, in the largest industrial plant in New Zealand, all of the steel manufacturing machinery which was controlled by computers ceased to operate. The problem was that the computer system manufacturer had failed to program 1996 as a leap year. As a result of this negligence, millions of dollars in machinery was ruined and the plant was out of business until new machinery could be obtained. This may be typical of the type of failures which we will see after January 1, 2000 across America. Serious consideration should be given to where the financial losses arising out of such negligence should be placed, on the negligent system software provider or on the business which purchased the software in the good-faith belief that it would function properly. If a situation such as the New Zealand steel mill occurs in the United States and currently pending federal legislation is past, a limitation of damages in the amount of \$250,000 would pay only a fraction of the cost of the losses of the steel mill. These damages limitations would result in millions of dollars in losses to the innocent party. A ninety day notice period would add insult to injury. These changes in the law would be particularly devastating since the insurance industry has indicated that they will deny coverage across the board on Y2K related losses.

Over centuries of well-reasoned law, it has been determined that losses of this type are better placed on the tortfeasor whose negligence caused the damage than on the party which suffers the loss. This is the current law in America which would control Y2K situations such as this one and it is respectfully submitted that such law should not be changed in order to protect

the wrongdoer at the expense of the innocent business victim. Retention of this law should provide motivation to business leaders to seek immediate Y2K repairs.

Thus, it is respectfully submitted that the law as it currently exists is far better suited to the resolution of Y2K claims than a complete overhaul of these time-honored principles, created without adequate time for reflection, amid a morass of misinformation and under the pressure of special interest groups who seek to protect themselves from the consequences of their own actions.

The Senate Year 2000 Committee has acknowledged the level of misinformation as follows:

The Committee has found that the most frustrating aspect of addressing the Year 2000 (Y2K) problem is sorting fact from fiction. . . . The internet surges with rumors of massive Y2K failures that turn out to be gross misstatements, while image sensitive corporations downplay real Y2K problems. S. Prt. No. 105-106-10 at 1 (1999).

One of the myths surrounding the Y2K litigation is the often cited Lloyds of London estimate of one-trillion-dollars in litigation costs. The one-trillion-dollar figure emanated from the testimony of Ann Coffou, Managing Director of Giga Information Group before the U.S. House of Representatives Science Committee on March 20, 1997, during which Ms. Coffou estimated that the Year 2000 litigation costs could perhaps top one-trillion-dollars. Ms. Coffou's estimate was later cited at a Year 2000 conference hosted by Lloyds of London and immediately became attributable to the Lloyds organization rather than the Giga Group. Obviously, those who want to use the trillion-dollar estimate for their own legislative purposes prefer to cite Lloyds of London rather than the Giga Group as the source of this estimate. There has been no scientific study and there is no basis other than guesswork as to the cost of litigation. The trillion-dollar "estimate" by the Giga Group is totally unfounded but once it achieved the attribution to Lloyds of London, the figure became gospel and is now quoted in the media and legislative hearings as if this unscientific guess by this small Y2K group should be afforded the dignity of scientific data. This is just another of the many myths that surround Y2K and certainly should not be given any credibility for changing 200 years of common law, and setting

aside the U.C.C., the business judgment rule, the duty of due care and joint and several liability.

Thus, in this atmosphere of misinformation, a short time-line and the pressures of special interest groups, it seems appropriate to inquire as to whether this is the proper time, place and forum in which to change 200 years of well-established common law and override the Uniform Commercial Code.

A further inquiry worthy of examination before changing the well-established rules by which business is conducted in America is what is the nature of the "crisis" with which we are dealing, what is the cause of the "crisis," and does it warrant the pre-emption of state laws and the Uniform Commercial Code.

Y2K is a computer problem which has been known to exist for decades. The business community has had decades of notice and an equal amount of time to address the solution to Y2K.

The Y2K crisis is not a computer crisis but rather a crisis of corporate leadership which irresponsible business leaders seek to compound with a crisis of corporate accountability. We are in this situation because business leaders have made the conscious decision to ignore the Y2K problem and to procrastinate in implementing solutions until what began as a business problem has now become a business crisis. Consider the findings of the Senate Special Committee on the Year 2000 regarding procrastination:

Leadership at the highest levels is lacking. A misconception pervades corporate boardrooms that Y2K is strictly a technical problem that does not warrant executive attention S. Prt. No. 105-106-10 at 3 (1999).

Many organizations critical to Americans' safety and well-being are still not fully engaged in finding a solution. . . . Id at 1.

Most affected industries and organizations started Y2K remediation too late. . . . Id at 2.

In discussing why many business leaders have been reluctant to "champion difficult and complex issues" the Senate Special Committee found that:

Y2K competes poorly against issues such as . . . market share and product development. It lacks familiarity, and in a results-driven economy, Y2K remediation costs are difficult to justify to . . . shareholders. Additionally, few wished to be associated with the potential repercussions of a failed Y2K

remediation attempt. Id at 7.

Thus, irresponsible business leaders have chosen to concentrate on market share and profits while ignoring the necessity of addressing Y2K remediation. Their procrastination in seeking Y2K solutions will now damage those with whom they do business. These are the leaders who are now seeking Congressional endorsement of their procrastination in the form of legislation which will absolve them of responsibility for the losses and damages which they are about to cause. This is particularly damaging to their consumers and business affiliates since the insurance industry has indicated the intention to deny Y2K coverage across the board. Therefore, Congressional absolution to the procrastinators, tortfeasors and wrongdoers will simply shift the damage to their customers and victims. It is respectfully submitted that the U.C.C., the law in fifty states, should not be rejected in favor of a federal Procrastinators Protection Act.

There is no acceptable excuse for businesses not being Y2K compliant other than their own procrastination in addressing the problem. A brief examination of the Y2K time-line indicates that the Y2K problem has been well known and steadily approaching for decades. In the late 1950's when magnetic tape format allowed greater memory capacity and less concern with space problems, programmers who were aware of the distant Y2K problem assumed that technical advances would eliminate the problem prior to 1/1/2000.

In 1960 Robert Bemer, a pioneering computer scientist, advocated use of the four-digit rather than the two-digit date format which is the basis of the Y2K problem. He was joined by forty-seven other industry specialists in an effort to devise computer programming standards that would use a four-digit rather than a two-digit date field. In 1964, IBM had the opportunity to correct the problem when the revolutionary system/360 mainframe came on line and set standards for mainframes for years to come. However, IBM chose to maintain the two-digit date field.

In 1970, Robert Bemer and eighty-six technical societies urged the Bureau of Standards to adopt the four-digit rather than the two-digit date field in order to avoid Y2K problems. The Bureau of Standards, at the urging of the same entities who now face the Y2K problem, adopted

the two-digit standard.

In 1979, Robert Bemer, writing in *Interface Age*, again reminded the computer world that the inevitable Y2K problems would occur on 1/1/2000 unless the defect was remedied. Mr. Bemer's warnings were again ignored.

Notice again went out to the industry in 1984 when Jerome and Marilyn Murray published Computers in Crisis: How to Avoid the Coming Worldwide Computer Collapse. The Murrys recognized the problem when they attempted to calculate annuities beyond the year 2000 and were unable to do so because of the Y2K date field problem. This notice by the Murrys put the entire manufacturing and computer industry on notice that this was a problem which needed to be addressed and timely remediated.

In 1986 a South African programmer, Chris Anderson, placed a magazine ad decrying "the time bomb in your IBM mainframe system" in reference to the two-digit date field. This occurred thirteen years ago at a time when responsible business leaders should have been seriously considering the remediation of impending Y2K problems. Instead, IBM responded to the magazine ad in 1986 by stating, "IBM and other vendors have known about this for many years. This problem is fully understood by IBM's software developers, who anticipate no difficulty in programming around it."

In 1989, the Social Security Administration computer experts found that overpayment recoupment systems did not work for dates after 2000 and realized that thirty-five million lines of code had to be reviewed. In 1994, the Social Security Administration timely began a three-year review of their software and today the Social Security Administration is the leader among government agencies in software remediation, having timely undertaken the management of the problem. In doing so, they set the standard of responsible conduct against which to measure those confronted with Y2K remediation problems.

In 1993, two events occurred which placed both the federal government and the business world on notice that the Y2K problem needed to be addressed immediately. The first event was the testing by engineers at North American Aerospace Defense Command of the NORAD Early Warning System. As the engineers set computer clocks forward to simulate 12:01 a.m. on

1/1/2000, every NORAD Early Warning computer screen froze. Additionally, in 1993, Peter De Jager wrote "Doomsday 2000," which was published in Computerworld concerning the Y2K defect. In this article, Mr. De Jager stated, "We and our computers were supposed to make life easier. This was our promise. What we have delivered is a catastrophe."

Responsible business leaders followed the lead of the Social Security Administration and heeded the warnings of Robert Bemer, the technical scientific community, and authors such as the Murrays and Peter De Jager. They timely undertook remediation of their Y2K problems in the early 1990's when there was sufficient time and talent available to solve the problems. Unfortunately, a large contingent of corporate leaders procrastinated, and failed and refused to follow the business judgment rule and to act with due care for the best interests of their corporation and are now to be found in the halls of Congress lobbying for Congressional forgiveness for the breach of contracts and the consequences of the negligent manner in which they have approached the Y2K problem. Such Congressional seal of approval on procrastination and corporate irresponsibility would send the wrong message to the voters, the wrong message to the public, and the wrong message to those who will soon be victimized by such corporate irresponsibility.

It is respectfully submitted that rather pre-empting the law of the fifty states controlling business activities, this Honorable House of Representatives may effectively help businesses who are actively seeking remediation and who have already undergone the cost of remediation and repair by considering the following types of legislation:

1. Legislation to aid in remediation and repair.
 - a. Create a federal repository for Y2K remediation solutions which could be traded across industries. There are more than five hundred programming languages and thirty-six million programs to be remediated. Offer a tax benefit to a company which achieves a remediation solution and places the solution in a repository for use by others with similar problems. The tax credit may be based upon the number of users who are aided by the remediation solution.
 - b. Suspend application of §482 of the Internal Revenue Code which requires that Y2K repairs by one division of a company be treated as a taxable asset if used by other divisions of the same company. This would promote the use of repair tools or software packages between divisions without such transfer between divisions being a taxable event;
 - c. Suspend the enforcement of the portion of the antitrust laws which would prevent the sharing of Year 2000 repairs and technologies within vertical industries

because of the impact on competition. Currently, the impact on competition which may result from sharing Y2K technologies and repairs may constitute a technical violation of the anti-trust laws. Any action which promotes the more expeditious repair of Y2K problems without adverse impact on other companies, should be encouraged without regard to the impact on competition.

2. Tax Relief.

- a. Allow the option to amortize the cost of Y2K repairs over several years or be treated as expenses in the year incurred;
- b. Issue a directive to the Internal Revenue Service that they are to minimize the risk to taxpayers from punitive IRS actions in the event that their withholding information or interest information is incorrectly recorded due to the Year 2000 errors;
- c. Provide additional corporate tax relief for businesses to compensate, to some extent, for the cost of the Y2K repairs;

3. Relief for Governmental Agencies.

There is a basis for concern about the impact of Y2K on governmental bodies ranging from small cities to larger cities and states. Governments at every level are confronted with a double impact on solvency. First, each government has to budget its own costs for remediation of governmental Y2K problems. Secondly, the financial impact on taxpaying citizens and businesses will adversely affect the bottom line of taxes collected by governmental bodies. Thus, each governmental body will be confronted with more bills to pay and less tax revenue with which to pay them. In order to avoid interruption of vital infrastructure services to our citizens, it is respectfully suggested that an emergency financial relief system be established for aiding governments which find themselves unable to deliver vital services as a result of this double financial impact.

4. Y2K Compliance.

It is respectfully suggested that a considerable amount of confusion and possibly even litigation may be avoided in the future by the adoption of a standard definition for "Y2K Compliant." At the present time the term is used very loosely without precise definition and businesses who are seeking to ascertain whether their vendors or those with whom they do business are "Y2K Compliant" should be cautious to ascertain that they and their vendors are defining the term in the same manner. It is respectfully suggested that the best definition for the term "Y2K Compliant" is found in the Federal Acquisition Regulation (FAR), part 39.002, published in Federal Acquisition Circular (FAC) 90-45:

"Year 2000 compliant means information technology that accurately processes date/time data (including, but not limited to, calculating, comparing, and sequencing) from, into, and between the twentieth and twenty-first centuries, and the years 1999 and 2000 and leap year calculations. Furthermore, Year 2000-compliant information technology, when used in combination with other information technology, shall accurately process date/time data if the other information technology properly exchanges date/time data with it."

To return to the original inquiry, it seems obvious that in the time remaining before the inevitable arrival of 12:01 a.m. on January 1, 2000, business entities which have procrastinated for several years in addressing Y2K remediation could best spend their time in long overdue efforts at Y2K solutions rather than pursuing a Congressional Seal of Approval on procrastination.

The law of all fifty states, the Uniform Commercial Code, the business judgment rule, the duty of due care and the concept of joint and several liability have been finely honed for decades to handle precisely the type of litigation which will be the hallmark of year 2000 lawsuits, business versus business. To set aside decades of law in order to protect those who brought about this crisis of corporate leadership would be unfair to the responsible business entities which are entitled to rely on the remedies which those well-established business rules provide. There is no need for federal legislation regarding Y2K liability.

Thank you for the opportunity to be heard on this important issue.

Curriculum Vitae

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EDUCATION:

Florida State University (B.A., 1963)
Vanderbilt University School of Law (J.D., 1966)

BUSINESS

Co-Founder: Insurance Corporation of America

Listed in: Who's Who in the World
Who's Who in American Law
Who's Who in America
Who's Who in Finance and Industry

CERTIFICATIONS:

Texas Board of Legal Specialization: Personal Injury Trial Law
Texas Board of Legal Specialization: Civil Trial Law
National College of Advocacy: Diplomat of Trial Advocacy

LEADERSHIP ROLES:

Southern Trial Lawyers Association - Past President
Texas Trial Lawyers Association - Past President
Texas Association of Certified Civil Trial Lawyers - Past President
Association of Trial Lawyers of America:
- Vice President (1994-1995)
- Secretary (1993-1994)
- Treasurer (1992-1993)
- Executive Committee (1991-1992)
- Board of Governors (1989-1992)
- House of Delegates (1985-1988)

CONTINUING LEGAL EDUCATION:

Lecturer in all 50 states, 6 Canadian provinces and 5 foreign countries
South Texas College of Law - Adjunct Faculty
National College of Advocacy - Board of Trustees - Past Chair
State Bar of Texas CLE - Past Chair

PUBLICATIONS

BOOKS:

Author, Structuring Settlements (ATLA Press, 1987)
Editor, Maximizing Damages in Wrongful Death and Personal Injury Litigation (ATLA, 1985)
Nations & Kilpatrick, "Texas Workers' Compensation" (Matthew Bender, 1990)
Contributing Author, "Texas Torts and Remedies" (Matthew Bender, 1988)
Contributing Author, "Construction Accidents" (Wiley Law Press, 1988)
Contributing Author, "The Anatomy of a Personal Injury Lawsuit" (ATLA, 3rd Edition)
Author of numerous journal articles, legal publications and CLE papers

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March 8, 1999

VIA FACSIMILE 202-225-4438

Mr. Joseph Sullivan
 Maj. Staff Assistant
 U.S. House of Representatives
 Committee on Science
 Subcommittee on Technology
 Washington, D.C. 20515

Re: Financial Disclosure

Dear Mr. Sullivan:

Please be advised that I have never received any federal funding or had any business connection with the federal government regarding Y2K issues.

Sincerely,

Howard L. Nations

Howard L. Nations

Chairwoman MORELLA. Thank you, Mr. Nations.

Now we turn to our last panelist, Mr. Walter Andrews, Partner, and Head of the Year 2000 Practice Group.

TESTIMONY OF WALTER J. ANDREWS

Mr. ANDREWS. Thank you, Chairwoman Morella, and Chairman Horn. Thank you for asking me to testify at today's important hearing. It is an honor for me to be here.

My name is Walter Andrews. I am a partner at the law firm of Wiley, Rein and Fielding, here in Washington, D.C. I am a constituent of Mr. Davis. As co-chair of our firm's year 2000 practice, I regularly counsel clients on the legal risk and ramifications they face as a result of the year 2000 problem.

My testimony today will address three topics. One, the liability issues and legal theories that already have been raised. Two, those legal issues we could expect to see in the future as a result of this problem. And three, what businesses can do now to mitigate their exposure to these liabilities. My testimony today will not address the technical aspects of the year 2000 problem, nor will it address particular legislation before Congress.

However, having been a computer programmer in the 1970s, and a litigator in the 1980s and 1990s, I perhaps uniquely can appreciate that there are different perspectives regarding the potential massive litigation regarding this issue, which as Chairman Horn stated, has been estimated may reach up to \$1 trillion in costs.

This is in stark comparison or contrast to the costs we actually witnessed in the 1990s with the massive asbestos litigation, which was about \$15 billion, and environmental litigation, of about \$18.4 billion. This chart provides a sense of the enormity of the potential year 2000 litigation costs.

At this point, we still have 9 months to go until January 1, 2000. Nonetheless, we currently have at least 55 lawsuits, most of them purporting to be class actions already having been filed over alleged year 2000 problems. In fact, this number probably represents only a small fraction of the number of year 2000-related lawsuits that ultimately will be filed, and probably is just the first wave of such litigation.

The largest category of cases filed to date involve software products that have not yet failed, but may cause harm if not remediated. Generally these have been class action suits brought against software developers. Most of the present litigation has thus far been unsuccessful due to lack of any actual present injury or because of relevant contract between the parties expressly excluded such claims.

It is important that contracts should be the first point of reference to define the parties' rights and obligations in any year 2000 dispute. Courts should resist turning contract disputes into tort actions. Similarly, it is important that cases not be allowed to proceed where there is no actual present injury, but the primary driving force is the seeking of legal fees.

In addition, some year 2000 suits have begun to raise negligence claims in addition to contract claims, which has created somewhat of a year 2000 litigation spillover effect. In fact, the next wave of year 2000 litigation, which may comprise injuries indirectly caused

by the year 2000 problem, may be where the greatest litigation costs will eventually lie. When we actually begin to see the kinds of failures that we have only now been contemplating, the ensuing litigation arguably could reach just about any entity that experiences a failure in its computer system. We could expect eventually to see suits brought against suppliers, vendors, and service providers at every level of the chain of distribution. Professional malpractice claims and shareholder suits also are increasingly likely to be raised.

What can businesses do now to minimize their liability exposure? Unfortunately, lawyers are often viewed as part of the problem for businesses by encouraging a year 2000 litigation explosion, rather than being viewed as part of the solution. Businesses must recognize, however, that obtaining legal counsel is part of the solution to their year 2000 problems.

Clients have sought the assistance of Wiley, Rein and Fielding, and other firms with expertise in this area to help prepare their businesses for the year 2000. Our firm's year 2000 practice group has been actively working for more than a year now on such liability issues, and counseling clients on minimizing their legal and financial liability exposure.

The bulk of a company's year 2000 legal audit should consist of analyzing the liability each company faces individually, and then crafting legal strategies to minimize that exposure, specifically tailored to each company's situation. Clients have started this process by examining their obligations and liabilities to others in the event of a failure in their operations.

They have also been analyzing existing contracts and legal relations with third parties, including reviewing third parties' websites, marketing materials, and advertisements for any year 2000 disclosures. In addition, clients have been contacting third parties to obtain adequate assurances of compliance.

Clients also have been renegotiating their contracts to include protections in the event of year 2000 failures by, for example, the inclusion of year 2000 warranties in contracts with vendors. Finally, clients have been focusing attention on the need to form emergency response plans in the event of a year 2000 failure.

In conclusion, the year 2000 problem, because of its pervasive nature, presents potentially staggering liability costs for individual entities, as well as for society as a whole. Because of the magnitude of these costs, businesses must take steps now to reduce their level of exposure and risk. Comprehensive year 2000 legal audits, in conjunction with aggressive year 2000 assessment and remediation programs are what businesses need to do now in order to avert a potential year 2000 liability catastrophe for themselves and for the economy as a whole.

Legal counsel can be part of the year 2000 solution, by helping businesses take responsibility for addressing their year 2000 problems, and to minimize their liability exposure.

Thank you, distinguished members of the Subcommittees.

[The statement of Mr. Andrews follows:]

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**STATEMENT OF
WALTER J. ANDREWS
WILEY, REIN & FIELDING
WASHINGTON, D.C.**

**BEFORE THE
SUBCOMMITTEE ON TECHNOLOGY
OF THE COMMITTEE ON SCIENCE**

**AND THE
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION AND TECHNOLOGY
OF THE COMMITTEE ON GOVERNMENT REFORM**

U.S. HOUSE OF REPRESENTATIVES

MARCH 9, 1999

Introduction

Thank you Chairwoman Morella and Chairman Horn, and thank you for asking me to testify at today's important hearing. It is an honor for me to be here.

My name is Walter J. Andrews, and I am a partner at the law firm of Wiley, Rein & Fielding here in Washington, D.C. Wiley, Rein & Fielding has been actively involved in evaluating the legal and financial liabilities arising out of the Year 2000 problem. As Co-Chair of the firm's Year 2000 Practice Group, I have counseled clients on the legal risks that their businesses may face as a result of the Year 2000 problem, and have supervised Year 2000 legal audits designed to identify and mitigate liability issues in clients' businesses related to the Year 2000 problem.

I appreciate the opportunity to testify today on the legal dimensions of the Year 2000 problem. I would like to note my testimony does not necessarily represent the view of any Wiley, Rein & Fielding client. Instead, consistent with this hearing's focus, my testimony will address three topics: (1) the liability issues and legal theories that already have been raised by the Year 2000 problem; (2) those legal issues we can expect to see in the future; and (3) what businesses should be doing now to mitigate their exposures to these liabilities.

As many observers have noted, the Year 2000 problem presents the potential for liability exposure of an almost unparalleled magnitude. Throughout the U.S.-and world economies, every link in the chain of commerce that is susceptible to a Year 2000 failure gives rise to vast liability exposure. Consider the widespread use of computers in every aspect of commercial life, and the widespread use of embedded microchips in all kinds of machinery, ranging from microwave ovens to merchant ships. We've all heard Year 2000 horror stories about the possibility of

airplanes crashing, elevators failing, pacemakers malfunctioning, and widespread power outages. We also should keep in mind the potential for cascading effects resulting from Year 2000 failures in the distribution chain, which could affect the availability of water, food and medicine. I am sure the Members recognize the potential for Year 2000 failures causing harms ranging from the merely annoying to the potentially fatal, and the consequent potential for vast liability exposure. According to estimates cited in a recent report by the Organisation for Economic Co-operation and Development, the worldwide costs of Year 2000 remediation may reach as high as \$600 billion. More importantly, the litigation costs of the Year 2000 problem have been estimated by the Gartner Group to reach up to \$1 trillion. Compare this figure to the costs we actually witnessed in the 1990's for asbestos litigation and environmental litigation, \$15 and \$18.4 billion respectively, and you will get some sense of the enormity of potential Year 2000 litigation costs.

My testimony today will not address technical aspects of the Year 2000 problem, nor will it address particular legislation before Congress or the need for such legislation. Rather, my testimony will focus on the legal issues posed by the Year 2000 problem, including the actual litigation we already have seen and the potential litigation we may see in the future. My testimony will also address our efforts at Wiley, Rein & Fielding to help clients prepare for and mitigate Year 2000 liabilities.

Litigation So Far

First, I would like to discuss the litigation that the Year 2000 problem already has generated. At this point, we still have 9 months to go until January 1, 2000. Nonetheless, at least 54 lawsuits, most of them purporting to be class actions, already have been filed over

alleged Year 2000 problems. In fact, this number probably represents only a small fraction of the number of Year 2000-related lawsuits that ultimately will be filed.

The largest category of cases filed to date involves software products that have not yet failed but may cause harm if not remediated. Generally, these suits have been class action suits against software developers. They raise a combination of contractual claims, such as breach of contract, breach of express warranties and implied warranties of merchantability and fitness under the Uniform Commercial Code, anticipatory repudiation and failure to give adequate assurances. Non-contractual claims include fraud and deceit, breach of the duty of good faith and fair dealing, violations of the federal Magnuson Moss Consumer Products Warranty Act, and violations of state deceptive trade practices acts. The plaintiffs typically seek compensatory damages, usually the costs of remediation or upgrade of the non-compliant product, punitive or other exemplary damages, disgorgement of the defendants' profits, attorney fees and court costs. The plaintiffs also typically seek injunctive relief for free patches or upgrades to the software.

The six class action lawsuits against Intuit, all of which have been dismissed, are typical of these suits against developers of allegedly non-compliant software. In the Intuit cases, the plaintiffs complained of Year 2000 defects in older versions of Intuit's Quicken personal finance software. The plaintiffs in these cases claimed that the software was unfit for the purposes for which it was meant to be used, for example to perform online banking functions or to maintain financial records accurately into the Year 2000. In response to these claims, Intuit generally asserted that: (1) the plaintiffs had failed to allege any actual injury because the Year 2000 defects would not cause malfunctions until the Year 2000; (2) that the plaintiffs had not given Intuit an opportunity to fix the alleged defects before bringing suit; and (3) that some of the plaintiffs had no contractual relationship with Intuit.

All six of the cases against Intuit were ultimately dismissed. In each dismissal, the court based its decision upon the lack of present, actual injury. Since few plaintiffs are likely to be able to allege present, actual injury in current Year 2000 litigation, the issue of the lack of actual injury likely will arise in other pending lawsuits alleging the Year 2000 non-compliance of software products.

A significant legal question facing us about the Year 2000 problem is, whose responsibility is it to fix the problem? As the case of *Paragon v. Macola* indicates, courts are looking to contract terms to answer this question. Like the Intuit cases, the *Paragon* case was ultimately dismissed. Unlike these other cases, however, *Paragon* was not dismissed based upon the lack of injury, but on the legal merits. In *Paragon*, the plaintiff's accounting software, which had been developed by the defendant, was allegedly Year 2000 non-compliant. The defendant provided Year 2000 compliant upgrades, but at a price. The plaintiff sued, seeking damages and injunctive relief. The court dismissed the plaintiffs' suit primarily based upon language in the contract between the parties that contained an express disclaimer of warranties. Thus, contractual terms governed the parties' respective Year 2000 liabilities in *Paragon*.

Contract terms also governed the liabilities of the parties in *ASE v. INCO*, a recent arbitration decision. In *ASE*, an arbitrator found that a systems developer was not liable under a 1995 contract for the purchaser's costs of remediating the system. The arbitrator found that Year 2000 remediation was neither addressed in the contract nor articulated as a goal of the project. Thus, as in the *Paragon* case, contract terms were found to govern the parties' liabilities.

Although it has not generally been the case, some of the Year 2000 suits have begun to raise negligence claims in addition to contractually based claims. For example, two of the class action complaints against the Medical Manager Corporation include claims of negligence. To

date, there has been no judicial ruling on the standards of care relevant to the Year 2000 problem. The issue of standards of care for software date design is significant in the Year 2000 context because it may determine whether the original developers of non-compliant software are held to be negligent and therefore liable for the consequences of the Year 2000 problem. Moreover, this issue will play into a much larger one, as courts determine whether contract terms should govern the parties' respective liabilities, as in the *Paragon* and *ASE* decisions, or whether tort law – the general legal principles governing one person's responsibilities toward others – should determine the allocation of liabilities arising from the Year 2000 problem.

A case involving Andersen Consulting LLP raised the standard of care issue squarely. Andersen had designed, customized and implemented a software package for J. Baker, a clothing retailer who later complained of Year 2000 problems in the system. Andersen argued in response that no Year 2000 compliant systems were available at the time it implemented the software. After mediation, Baker dropped its claims against Andersen, and thus no Year 2000 standard of care was judicially established. Because of its significance, however, the issue of standard of care likely will be litigated further in future cases.

To date, most of the suits in the current wave of Year 2000 litigation have directly involved users and distributors of allegedly non-compliant software. The Intuit cases are a good example. But we are already beginning to see a kind of Year 2000 litigation spill-over effect. That is because, while the Year 2000 problem is at root a programming problem, it has the potential to affect every aspect of commerce that relies on date-related programming in software, firmware and hardware, even if only indirectly. Thus, direct purchasers of software are not going to be the only people affected by the Year 2000 problem. In fact, the next wave of Year 2000

litigation, namely disputes over injuries indirectly caused by the Year 2000 problem, may be where the greatest litigation costs eventually lie.

Shareholder actions comprise the largest category of current lawsuits based on such indirect Year 2000 claims. Most of these shareholder suits have involved alleged misstatements about the probable success of a company's Year 2000 remediation products and services, allegedly resulting in inflated share prices. A derivative action also has been brought against Medical Manager Corporation, its principals and the brokers that handled its initial public offering, alleging that they failed to disclose the intention to shorten the life span of existing Medical Manager software and to replace it with a Year 2000 compliant version. These shareholder actions mark only the beginning of the potential litigation spill-over effect. When the Year 2000 comes to pass, and we actually begin to see the kinds of failures we have only been contemplating, the ensuing litigation could ensnare just about any entity that experiences a failure in its computer system or other machinery, or whose operations rely on some such entity.

Future Litigation.

At this point, I would like to describe some of the Year 2000 litigation that we can expect to see in the future. In addition to the current litigation against software developers and other developers of information technology, we can expect eventually to see suits brought against suppliers, vendors and service businesses at every level of the chain of distribution. And the legal claims that eventually may be pursued under the rubric of the Year 2000 problem span the range from contract and tort law to statutory claims. Common law breach of contract and breach of warranty under the Uniform Commercial Code have been the focus of much of the current

litigation. Negligence and professional malpractice claims also are increasingly likely to be raised, for example against the designers of non-compliant systems. As I have indicated, negligence claims already have begun cropping up against software developer Medical Manager Corporation.

We can also expect claims of negligent and strict products liability for non-compliant products. In situations where, as is often the case, sellers have made representations about the continuity of their services or products operating into the Year 2000, we should expect to see claims of negligent misrepresentation or fraudulent misrepresentation raised, along with claims brought under state laws regarding deceptive trade practices. Where misrepresentations about consumer products are at issue, we can expect claims under the federal Magnuson Moss Consumer Products Warranty Act.

As for securities claims, the cases already filed involve Year 2000 claims premised on materially misleading statements made by officers and directors of two types of companies, either those that sell Year 2000 remediation products and services, or those that sell non-compliant software products. In the future, as companies generally begin to suffer from Year 2000 failures, shareholder suits may be brought against any type of company, alleging that its directors and officers failed to take sufficient steps to fix Year 2000 problems or failed sufficiently to disclose their failure to take such steps. Similar Year 2000 claims premised on breach of fiduciary duties might be raised beyond the corporate context as well. For example, benefits administrators under the federal Employee Retirement Income Security Act (ERISA) might be sued for failure to take sufficient steps to remedy Year 2000 problems with respect to the pension and health plans they administer.

Legal Preparation for the Year 2000

So far, I have discussed the potential for litigation and ultimate liability in the event of future Year 2000 failures. At this point I would like to address what businesses can do now to minimize their liability exposure. Businesses must take forward-looking, pro-active measures now to minimize their exposure to the Year 2000 problem. Naturally, technical remediation of systems and equipment affected by the Year 2000 problem should be given a high priority. The legal aspects of the Year 2000 problem, however, should also be given priority. Unfortunately, lawyers are often viewed as part of the *problem* for businesses, by encouraging a future Year 2000 litigation explosion, rather than part of the solution. Businesses must recognize, however, that obtaining legal counsel is part of the solution to their Year 2000 problems. Legal counsel can aid businesses right now in their Year 2000 efforts by helping them to minimize their liability exposure and to take responsibility for addressing the Year 2000 problems in their operations. In fact, legal counsel may even aid businesses in identifying areas of potential Year 2000 failures in their operations, going hand in hand with technical remediation.

Cognizant of the potentially devastating liability exposure posed by the Year 2000 problem, clients have sought Wiley, Rein & Fielding's assistance to help prepare their businesses for the Year 2000. In fact, our firm's Year 2000 Practice Group has been actively working for more than a year now on Year 2000 liability issues and counseling clients on minimizing their legal and financial liability exposure.

Generally, clients have begun their Year 2000 legal preparations by focusing attention on the magnitude of the Year 2000 problem and on the need to commit to Year 2000 readiness at the highest management levels, both in terms of budget and personnel. Businesses also have been

extensively documenting both their commitment to and their efforts toward being Year 2000 compliant. Furthermore, they have been centralizing and coordinating Year 2000 readiness efforts in one team to the greatest extent possible, operating across all levels and divisions. Besides fostering efficient compliance efforts and efficient distribution of information about those efforts, this approach has the advantage of protecting client rights in the event of future litigation. For example, centralizing Year 2000 efforts helps ensure that a client's Year 2000 statements are consistent, and that the client consistently invokes the protections of the recently enacted Year 2000 Information Readiness and Disclosure Act (also known as IRDA).

To the extent that our clients are only beginning to become familiar with the Year 2000 problem, Wiley, Rein & Fielding's attorneys have provided guidance on the kinds of assessment, remediation and testing processes that businesses should institute to render their systems, products and services compliant. Certainly, businesses should begin by focusing their attention on mission-critical systems first, to identify those elements of their businesses which are essential to their continued operation.

These are some of the initial steps businesses have taken to prepare for the legal ramifications of the Year 2000 problem. The bulk of a company's Year 2000 legal audit, however, consists of analyzing the liability exposure each company faces individually and then crafting legal strategies to minimize that exposure, specifically tailored to each company's situation. Businesses have started this process by examining their obligations and liabilities to others in the event of a failure in their operations. They also have been analyzing existing contracts and legal relationships with third parties such as suppliers, vendors, customers and independent contractors. Businesses also have been reviewing third parties' websites, marketing materials and advertising for any Year 2000 disclosures. In addition, businesses have been

contacting third parties to obtain adequate assurances or certificates of compliance stating that third party products and services will be available and functioning on and beyond problem dates. To obtain such assurances, businesses have been sending letters and Year 2000 questionnaires to their third party vendors and suppliers, along with follow-up letters when necessary.

Businesses also have been renegotiating their contracts to include protections in the event of Year 2000 failures, for example, the inclusion of Year 2000 warranties in contracts with vendors. Often, legal counseling includes drafting definitions of what it means to be Year 2000 compliant, tailored to meet the needs of individual clients. Certainly, with respect to new contracts, clients have often included Year 2000 warranty and indemnification provisions, as well as explicitly spelled out obligations to repair and replace technology where necessary.

Year 2000 legal counseling also extends to regulatory matters. As more and more government agencies are becoming familiar with the Year 2000 problem, these agencies are increasingly taking steps to assess the extent both of the Year 2000 problem and of remediation efforts. Some are also taking steps more directly aimed at minimizing the impact of Year 2000 problems within the areas of industry they regulate.

For example, the SEC last year released interpretive guidelines explaining public companies' obligations to disclose their Year 2000 problems and remediation efforts in financial reports filed with the SEC. Bank regulators are requiring banks to ensure that the companies to which they have loaned money are undertaking Year 2000 remediation efforts. The FCC has begun a series of efforts both to gather information about the Year 2000 readiness of the companies it regulates and to educate the industry and the public about the state of Year 2000 readiness in the communications industry. The FDA has given manufacturers guidance on its expectations with respect to the Year 2000 compliance of medical devices. In response to these

and other regulatory initiatives, our clients have sought counseling to ensure that their operations, products and services comply with regulatory requirements related to the Year 2000 problem.

Finally, clients have been focusing attention on the need to form emergency response plans in the event of a Year 2000 failure. The first part of such an endeavor is to establish an operational contingency plan, attempting to assure that mission-critical systems function in spite of possible failures. The second part establishes a legal contingency plan, which identifies avenues for responding to potential areas of liability along with immediate actions that clients must take to avail themselves of relevant legal protections in the event of Year 2000 failures.

Hopefully, after undergoing a comprehensive Year 2000 legal audit, our clients will have minimized their liability exposure.

Conclusion

The Year 2000 problem, because of its pervasive nature, presents potentially staggering liability costs for individual entities as well as for our society as a whole. Because of the magnitude of these costs, businesses must take steps now to ensure that their systems are Year 2000 compliant and to reduce their level of exposure and risk. Comprehensive Year 2000 legal audits, in conjunction with aggressive Year 2000 assessment and remediation programs, are what businesses need to do now in order to avert a potential Year 2000 liability catastrophe both for themselves and for the economy as a whole. Legal counsel can be part of the Year 2000 solution by helping businesses to take responsibility for addressing their Year 2000 problems and to minimize their liability exposure.

Thank you, Distinguished Members of the Subcommittee. This concludes my testimony. I would be pleased to respond to any questions you may have.

First Cases Foreshadow Later Litigation

READING EARLY RETURNS

BY WALTER J. ANDREWS,
ROBERT J. BUTLER,
MEREDITH FUCHS,
AND PRAVEEN GOYAL

Even though a year remains before Jan. 1, 2000, the dreaded millennium bug has already caused an infestation—not of software failures, but of lawsuits anticipating such failures and their predicted consequences. From these cases, we can glean much about the issues that will arise when the real onslaught of Year 2000 litigation hits the courts next year.

The largest group of lawsuits already filed allege that software design failures either have caused harm or may do so if not remedied. These actions raise many issues about the nature of injury, the types of damages recoverable, and privity of contract. The next largest category consists of shareholder actions claiming that Y2K statements have affected stock prices. Still other actions relate to alleged hardware failures, consultant mistakes, and insurance coverage disputes.

Typical of the litigation targeting software developers are the cases against Intuit Inc. Six suits—three in New York and three in California—have been filed against Intuit for alleged Y2K defects in its Quicken personal finance software. The suits generally allege some combination of breach of implied and express warranties, anticipatory repudiation, and failure to provide adequate assurances. Noncontractual claims include violation of the federal Magnuson-Moss Consumer Products Warranty Act, fraud and deceit, deceptive trade practices, and breach of the duty of good faith and fair dealing.

The plaintiffs generally seek compensatory damages, disgorgement of Intuit's revenues from sales of noncompliant versions of Quicken, treble damages, punitive damages, attorney fees, and court costs. They also seek to compel Intuit to offer free Y2K compliant upgrades and to freeze Intuit's assets. See, e.g., *Chitelli v. Intuit Inc.*, No. 98-013559 (N.Y. Sup. Ct., filed May 13, 1998); *Issokson v. Intuit Inc.*, No. CV773646 (Cal. Super. Ct., filed April 28, 1998).

The Intuit cases highlight the question: What is injury? The company argued in California and New York that the plaintiffs failed to allege any actual damages caused by the

Y2K problems claimed to exist in Quicken. In fact, by the time the cases were heard, Intuit had notified Quicken users that free Y2K compliant upgrades would be available. The company contended that the plaintiffs had not given it an opportunity to cure before suing.

Intuit sought dismissal or at least a stay of the complaints. The New York court agreed, dismissing three of the suits. The California court dismissed one, which was refilled, and is now considering whether to dismiss it and the other two pending before it.

A SIGNIFICANT DEFENSE

In a similar case not involving Intuit, the court in *Peerless Wall & Window Coverings v. Synchronics*, No. 98-1084 (W.D. Pa., filed June 19, 1998), granted a temporary stay to permit the defendant to determine whether its software posed a Y2K problem and to remediate at no cost to the general public. The court noted that the plaintiffs had not experienced actual damage and that none was reasonably anticipated before the end of the calendar year. Taken together with the results so far in the Intuit litigation, this decision suggests that a plaintiff's inability to allege actual injury will be a significant defense prior to the Year 2000.

By contrast, the plaintiffs in the now infamous *Produce Palace International v. TEC-America Corp.*, No. 97-330-CK (Mich. Cir. Ct., filed June 12, 1997), alleged actual losses as a result of the defendants' noncompliant system. The Michigan Circuit Court denied the defendants' motions to dismiss, upholding all the claims against the retailer and those claims against the distributor for breach of warranties, negligent repair, and misrepresentation. The parties later settled after mediation.

Rather than seeking damages for losses not yet sustained, some plaintiffs are asking for injunctive relief to force defendants to fix the problem before 2000. See, e.g., *SPC Inc. v. NeuralTech Inc.*, No. 8:98-CV-521 (D. Neb., filed Oct. 23, 1998); *Cobb & Sheasley v. Equitrac Corp.*, No. CV-98-809-H (Ala. Cir. Ct., filed Nov. 13, 1998).

Let's assume that a post-Year 2000 plaintiff will be able to prove actual damages. Intuit raised another significant defense that will

surely come into play—the double bind of the “economic loss” doctrine and contractual privity. The economic loss doctrine limits a plaintiff in contractual privity with a defendant to contractual remedies if the loss alleged is purely economic. Intuit argued that the plaintiffs' tort claims for purely economic loss were thus barred. Then Intuit also contended that all contractual claims should be dismissed because several of the plaintiffs had obtained their software from middlemen and thus were not in privity with Intuit. Under this argument, only contract remedies are permitted because any losses alleged are economic, but lack of privity denies those contract remedies.

Where the economic loss/privity two-step does not apply, software developer defendants have focused on the language of the relevant agreements to limit liability. For example, in *Paragon Networks International v. Macola Inc.*, No. 98-CV-0119 (Ohio C.P., filed April 1, 1998), the plaintiff, facing a privity argument similar to Intuit's, produced a copy of the defendant's license agreement. In response, the defendant argued that a disclaimer in the agreement barred all claims for breach of express and implied warranty. Paragon countered that it had no opportunity to negotiate the license terms prior to purchase and, thus, there was no meeting of the minds. Paragon further argued that the disclaimer at issue was unconscionable to enforce. Its claims were recently dismissed based on the express terms of the license agreement.

Eight Y2K cases have been filed against the Medical Manager Corp. and related entities, raising claims involving Medical Manager software. All but two have tentatively been settled as of this writing. The two continuing cases suggest that plaintiffs lawyers are already learning lessons from the first Y2K actions.

The earlier Medical Manager cases typically alleged breach of contract, breach of Uniform Commercial Code-implied warranties, Magnuson-Moss Act violations, and deceptive trade practices. The two remaining complaints also allege that the defendant promised free upgrades for software containing “bugs” and raise negligence claims not present in earlier suits. While they do not claim past or present Year 2000 injury, they do allege “a clear

and present danger of risk and potential harm to patients of medical specialists" due to the specialists' reliance on the software for monitoring, notification, and treatment efforts. See *Highland Park Medical Associates v. Medical Manager Corp.*, No. 98 C 7022 (N.D. Ill., amended complaint filed Nov. 5, 1998); *MVA Rehabilitation Associates v. Medical Manager Corp.*, No. 98-30217-MAP (D. Mass., filed Nov. 12, 1998).

DUTY TO REMEDIATE?

Does a software developer that sold products with the millennium bug in the past have a duty to remediate now? A recent arbitration decision may shed light on how courts will react to such a claim.

In *ASE Limited v. INCO Alloys International Inc.*, No. AAA 35-199-0127-98-DEU (Nov. 17, 1998)—the first known legal determination of liability relating to the Y2K problem—an arbitrator held that a systems developer is not currently liable under a 1995 contract for Y2K remediation damages. The purchaser sought to terminate the contract, initially for reasons other than Y2K noncompliance, and the developer filed suit. In response, the purchaser claimed that the developer was liable for the \$3.9 million cost of making the existing system Y2K compliant. The arbitrator rejected the purchaser's arguments, finding that "year 2000 remediation" was neither addressed in the contract nor articulated as a goal of the project, and that a document exchanged between the parties indicated that "year 2000 mitigation" was not within the project's scope.

Another broad class of Year 2000 claims is shareholder litigation. Within this class, the largest group of cases involves alleged misstatements about the probable success of a company's or a new acquisition's Y2K remediation products and services. See, e.g., *Steinberg v. PRT Group*, No. 98-CIV-6550 (S.D.N.Y., filed Sept. 16, 1998); *Downey v. Chan*, No. 1:98-CV-10578 (D. Mass.). There are two suits against *Command Systems Inc.* alleging that the company's initial share prices were artificially inflated by the company's false representations that it would focus on selling Y2K business solutions. See *Doney v. Command Systems Inc.*, No. 98-3279 (S.D.N.Y., filed May 6, 1998); *Steinberg v. Command Systems Inc.*, No. 98-3320 (S.D.N.Y., filed May 8, 1998).

Poller v. Micro Focus Group, No. 98-CIV-8619 (S.D.N.Y., filed Dec. 4, 1998), represents a second variation. This suit was brought on behalf of shareholders of a company that acquired a provider of Y2K remediation products and services, as well as shareholders who bought stock in the provider during the class period. The suit alleges that the provider artificially inflated share prices by making false

and misleading statements about the retention of personnel critical to its Y2K operations.

In a third variation, a shareholder derivative action was brought against *Medical Manager*, its principals, and the brokers that handled its initial public offering, in *Ehlen v. Singer*, No. 8:98-CV-02168 (M.D. Fla., filed Oct. 23, 1998). The complaint alleges that *Medical Manager* failed to disclose its intention to shorten the life span of its existing software and to promote a Y2K compliant version of the software. It also charges that the company failed to disclose the impact of not providing support for the noncompliant version.

These days, Year 2000 litigation primarily involves software and systems developers, but they are not the only targets. Hardware manufacturers, consultants, and insurance companies are also seeing the beginning of what may be a deluge.

READINESS DISCLOSURES

Micron Electronics Inc. has been targeted for Y2K defects in its computer hardware products. See *Hannah Films Inc. v. Micron Electronics Inc.*, No. CV98-05692 (D. Idaho, filed Oct. 26, 1998). While the claims are similar to those against software developers like *Intuit*, the *Micron* case may also raise issues under the recently enacted Year 2000 Information and Readiness Disclosure Act (IRDA).

The complaint refers to *Micron's* Web site statements about its products' Y2K compliance and to its Web site's offers to sell fixes for noncompliant products. After IRDA was signed into law, *Micron* retroactively converted these statements into so-called Year 2000 readiness disclosures. Under IRDA, such disclosures made in good faith are generally inadmissible in state or federal civil actions pending after July 14, 1998, to prove the "accuracy or truth" of any Y2K statement set forth in the disclosure, unless the disclosure provides grounds for anticipatory breach, repudiation of a contract, or a similar claim. The *Micron* case is pending.

The most significant case involving consultants so far may be one brought by *Andersen Consulting LLP* and raising the issue of standards of care. *Andersen* designed, customized, and implemented a software package for clothing retailer *J. Baker Inc.* *J. Baker* later complained of Y2K defects in the system. *Andersen*, in a declaratory judgment action, argued that appropriate Y2K compliant software was unavailable at the time of its work for *J. Baker*, and that customizing an existing package would not have been economically viable. See *Young v. J.*

Baker Inc., No. 98-01597 (Mass. Super. Ct., filed Aug. 28, 1998). No precedent for Y2K standards of care was established because *J. Baker* recently dropped its claims after mediation.

ENTER INSURANCE COMPANIES

Year 2000 litigation has not involved many insurance companies—yet. In what surely is only a glimpse at the wave to come, the *Cincinnati Insurance Co.* recently filed a declaratory judgment action maintaining that it has no duty to defend or indemnify its policyholder *Source Data Systems Inc. (SDS)* in a Y2K suit. Earlier, *Pineville Community Hospital* had filed a separate suit against *SDS*, alleging they had misrepresented their *MEDNET* software as Y2K compliant, and making an array of contract and tort claims.

In its declaratory judgment action against *SDS* and *Pineville*, *Cincinnati Insurance* contends that *Pineville's* claims are not based on any "occurrence" or "property damage" that took place during the policy period. Moreover, the insurer argues, *Pineville's* suit is based on tortious conduct and breach of contract, rather than occurrences or property damage as defined under the policy. *Cincinnati Insurance* alleges that the claimed losses are barred under the policy as "expected or intended from the standpoint of the insured," and that the loss was known, rather than fortuitous, from the viewpoint of *SDS*. Finally, *Cincinnati Insurance* contends that *Pineville* does not seek recovery for amounts paid "as damages" by *SDS*, as defined by the policy. See *Cincinnati Insurance Co. v. Source Data Systems Inc. and Pineville Community Hospital Association Inc.*, No. C 98-144 MJM (N.D. Iowa, filed Dec. 4, 1998). This case is probably just the first of many that will arise out of policyholders' efforts to shift their Y2K costs on to insurers.

Taken together, all these cases provide only a hint of the Year 2000 litigation to come. Apprehensive businesses everywhere are analyzing their commercial relationships for potential Y2K failures, whether they are their own or those of the parties with whom they deal. For now, their primary concern is being able to perform in the event of failures. But when the Year 2000 finally arrives, the ensuing flood of disputes may urgently demand their attention as well.

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Commentary**Year 2000 Litigation May Be The Testing Ground For
The New Restatement Of Products Liability Law**

By
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and
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I. Introduction

The Restatement (Third) of Torts: Products Liability ("Restatement") was adopted by the American Law Institute on May 20, 1997 and has been both criticized and heralded by members of the plaintiff and defense bar. Although Restatements do not, on their own, have the force of law, both of the earlier Restatements of Torts have been relied upon by courts and have exerted substantial influence on the development of tort law. The Third Restatement's description of the state of products liability law and the persuasiveness of its recommended refinements to that body of law, however, have yet to be extensively tested.

Litigation arising out of the much anticipated Year 2000 problem may provide some of the first opportunities for courts to apply the new Restatement. The Year 2000 problem likely will lead to a host of problems, including the corruption of data, malfunctions, and in some instances, complete system failures. The impact will be as widespread and varied as the use of computer technology itself. Air traffic radar screens, weapons control systems, medical equipment, and traffic lights could shut-down. Utility and communications companies may be unable to provide service. The Year 2000 problem could well cause personal injuries and deaths, and significant losses.

Of course, such losses inevitably will breed litigation, and plaintiffs are sure to pursue relief in part under product liability theories. In particular, manufacturers and distributors of software and embedded chips — the two most likely sources of Year 2000 failures — may become frequent targets of product liability claims. Accordingly, Year 2000 litigation could pose an important early test for the new legal concepts and public policy choices embodied in the Third Restatement.

This article discusses the Restatement's potential impact on Year 2000-related products liability litigation. After providing a brief overview of the law of products liability, the article highlights several threshold issues that are likely to arise in Year 2000 cases. The

article then examines the potential for Year 2000-related liability under each of the three categories of actionable product defects recognized in the Restatement — manufacturing defects, design defects, and failure-to-warn defects. In particular, the new Restatement incorporates several changes that may have significance in the Year 2000 context. This article highlights the effect that these changes may have on Year 2000-related product liability claims.

II. Products Liability Primer

The law of products liability concerns the liability of commercial sellers for injury to persons and damage to property caused by defective products. The policy rationale underlying modern products liability law is that commercial sellers are in the best position to reduce the risks posed by defective products.

Section 402A of the Restatement (Second) of Torts was one of the original sources for the products liability standards that have become the common law in most states. To provide sellers with a powerful incentive to curtail the risks associated with defective products, Section 402A imposed "strict liability" for products sold "in a defective condition unreasonably dangerous to the user or consumer or to his property."¹ Liability under the section is "strict" in that a seller is accountable for defects even if the seller exercised all reasonable care in the preparation and sale of the product. Although the authors of section 402A focused on defects stemming from the manufacture of products, many courts attempted to apply the same standard of liability to so-called design defects and a seller's failure to provide a warning.

The Third Restatement modifies Section 402A's scheme of liability in several important respects. *First*, the new Restatement expressly defines three categories of defects for which commercial sellers may be liable: manufacturing defects; design defects; and warning defects. *Second*, although the Restatement retains strict liability for manufacturing defects, it abandons true strict liability for design and warning defects, and adopts standards of liability that require some degree of fault on the part of defendant sellers. For example, the Restatement requires proof of a reasonable alternative design in cases involving a design defect and eliminates the use of a consumer expectations test. *Third*, the Restatement appears to lessen the protection that commercial entities may gain by placing a prominent warning on a product that causes injury.

III. Likely Threshold Issues in Year 2000-Related Products Liability Litigation

The Restatement establishes a limited scope of liability for manufacturers, distributors, and sellers of defective products. Under the Restatement, plaintiffs may assert products liability claims only against those engaged in the business of selling or distributing products that have caused harm to persons or property other than the product itself.

Year 2000-related products liability litigation frequently may hinge on several threshold issues that arise from the boundaries of liability delineated in the Restatement. A Year 2000 defendant may rely on at least two arguments in attempting to convince the court that a claim does not fall within the Restatement's parameters. First, a defendant may argue that the plaintiff's claim is not cognizable under products liability law, because the software or embedded chip that caused the Year 2000-related harm is not a "prod-

uct" within the meaning of the Restatement's definition of that term. Second, a defendant may assert that a plaintiff suffered no recoverable loss under the law of products liability, because the Year 2000-related failure caused no injuries to persons or to property other than the allegedly defective component itself. Each of these threshold issues will be considered in turn.

A. Are Chips Or Software 'Products'?

Courts may look to the Restatement in attempting to answer the threshold question of whether the computer chip or software alleged to be the source of a Year 2000-related injury qualifies as a "product" under the law of products liability. The Restatement provides: "A product is tangible personal property distributed commercially for use or consumption. . . . Services, even when provided commercially, are not products."¹

A chip is a small piece of semiconductor on which an integrated circuit is embedded. Although there are many different types of chips, in general they are all devices used to control, monitor, or assist the operation of equipment or machinery. In computers, many chips are placed on electronic boards called printed circuit boards. Embedded chips facilitate the operation of a variety of equipment, from nuclear power stations and elevators, to home appliances and smoke detectors. Although a chip is composed of tangible material that can be touched or held, a defendant-chip seller may seek to avoid product liability actions by focusing a court's attention on the intangible software that makes the chip function, and may argue that the chip is merely the physical encapsulation of software, which is the true cause of the Year 2000 failure. Thus, a court's characterization of the source of the Year 2000-related injury may be crucial in determining whether a chip manufacturer, or someone before or after the manufacturer in the design and distribution of the chip, will be subject to product liability claims.

Unlike embedded chips, software that is not contained in a chip clearly is not a tangible item that can be touched or held. The term "software" describes a number of things including computer instructions, data or anything else that can be stored electronically. Software storage devices and display devices such as diskettes, CD-roms, and monitors, are hardware. The Restatement recognizes that products liability law has not resolved whether software can be characterized as a "product."

Accordingly, the categorization of software is likely to be a difficult and important issue in early cases involving Year 2000-related products liability claims against software manufacturers and distributors. Defendants generally will argue that software is the embodiment of an intellectual process or an idea, and that the production or development of software is a service. Products liability law generally has distinguished between intangible ideas and tangible items used for recording those ideas. For example, the words recorded in a book are considered intangible ideas, even though the paper on which they are recorded and the ink with which they are recorded may be products.³ Other seemingly intangible elements such as electricity, however, have been found to be "products" in certain limited circumstances.⁴ In addition, because software is not particularly useful without a chip or hardware, plaintiffs may argue that it is functionally analogous to tangible personal property. Plaintiffs also may argue that, regardless of its intangibility, public policy reasons support viewing software as a "product." The Restatement provides some support for such arguments made in appropriate circumstances.⁵

The Restatement acknowledges that the tangibility of software has been considered in the context of different areas of law and that courts may draw on these sources in products liability litigation. For instance, in cases involving claims brought under the Uniform Commercial Code ("UCC"), courts have had to consider similar issues with respect to whether software is a "good." These cases generally hold that mass-marketed, "off-the-shelf" software is considered a "good" while customized software is considered a service.⁶ In the tax area, the issue has been considered as well. Tax cases have found software to be tangible and subject to sales tax or intangible based on a similar distinction being made between off-the-shelf and customized software.⁷

B. Did The Year 2000 Failure Cause Harm To Persons Or To 'Other' Property?

Another threshold question in Year 2000-related products liability litigation will be whether the Year 2000 failure caused injury to persons or property other than the product itself. The Restatement excludes recovery for "pure economic loss," including loss of the product that itself caused the injury.⁸ Often, in a commercial setting the only injuries will be economic losses such as damages for inadequate value, costs of repair, replacement of a defective product or consequential claims that are not connected to a claim of personal injury or damage to other property. At least one case has held that the loss of electronic data is an economic loss and not a loss of property.⁹ Mere economic loss cannot be the basis of a products liability claim.

Under the Restatement's formulation, harm to surrounding property is harm to property other than the product itself, and thus recoverable.¹⁰ The determination of what constitutes "other property" often will be difficult in the Year 2000 context, however, where a non-compliant component of a product, machine or system damages the rest of the machine. The question of when a component is a separate product and when it is integrated into a larger product such that damage to the larger product is not considered damage to "other property" is likely to be the source of a great deal of litigation in Year 2000 product liability cases.

IV. Year 2000-Related Liability For Product Defects Under The Restatement

Product defects are divided functionally under the Restatement into three categories: manufacturing defects, design defects, and defects based upon inadequate instructions or warnings. The potential for Year 2000-related liability under each of these defect categories is considered in turn.

A. Manufacturing Defects Related To The Year 2000 Problem

A manufacturing defect exists "when the product departs from its intended design even though all possible care was exercised in the preparation and marketing of the product."¹¹ In general, it seems unlikely that many Year 2000-related product failures will involve actionable manufacturing defects. In order to prove such a case, a plaintiff would have to show that the product was designed to be Year 2000 compliant, but implementation of that design specification failed and the product ended up non-compliant. Where a deliberate programming decision was made that involved two-digit year coding, it will be almost impossible to demonstrate that something unintended occurred in the manufacturing process.

B. Design Defects Related To The Year 2000 Problem

A design defect exists "when the foreseeable risks of harm posed by the product could have been reduced or avoided by the adoption of a reasonable alternative design by the seller or other distributor, or a predecessor in the commercial chain of distribution, and the omission of the alternative design renders the product not reasonably safe."¹² This formulation of the design defect definition has been widely interpreted as eliminating strict liability in design defect cases. As discussed above, strict liability is a concept that imposes liability on the seller or distributor of a product that caused injury without any finding that the seller or distributor is at fault for the product defect. The employment of fault-based concepts such as reasonableness and foreseeability in the Restatement's definition of a design defect, therefore, suggests that true "strict liability" is not available in design defect cases.

The Restatement's most controversial change is its requirement that a plaintiff establish the availability of a reasonable alternative design to demonstrate that the injury-causing product was defective. Plaintiffs' attorneys have claimed that this requirement imposes an impossible burden on plaintiffs, and improperly shifts the burden away from defendants who usually possess the technical resources and knowledge concerning the design process. To have any hope of meeting the standard, plaintiffs will be required to retain expert witnesses, which may be prohibitively expensive. Plaintiff's lawyers also have criticized this requirement as constraining the jury's role to merely comparing the merits of competing designs. In a world in which products are increasingly complex and involve technologies that are not understood by the ordinary person, lawyers may find it necessary to find new methods for explaining these difficult concepts to the average juror.

The reasonable alternative design requirement, if adopted in the various jurisdictions, likely will be an important focus in Year 2000 litigation. On the one hand, a plaintiff in a Year 2000 case may try to meet this requirement by showing that it was possible to design software and chips to be Year 2000 compliant. On the other hand, defendants will argue, as has been argued in one of the early Year 2000 cases brought by a computer consultant, that such an option was cost-prohibitive.¹³

The Restatement suggests that the reasonable alternative design requirement should replace the "consumer expectations" test for design defects currently used in many states. Under the consumer expectations test, proof that a product failed to perform as safely as an ordinary consumer expected it to perform would constitute proof of a defective design. The argument for abolition of the consumer expectations test is that the test rests on subjective expectations of consumers, whereas the objective standard of an alternative design will be less vague. The consumer expectations test could be problematic for defendants in Year 2000 design defect cases as consumers largely will argue that they did not expect a product to suddenly stop functioning on January 1, 2000. In applying the consumer expectations test, courts may consider the length of product warranties, expected shelf lives, product life-cycles, maintenance schedules and the like. Courts also are likely to consider representations made in promotional literature and advertisements that would be far less significant under a reasonable alternative design standard.

For those plaintiffs who are unable to satisfy the reasonable alternative design requirement, the Restatement provides several alternative "catch-all" bases of liability for de-

fects. Under the Restatement, a plaintiff may rely on circumstantial evidence to show that "when the incident that harmed the plaintiff [occurred]: (a) [it] was of a kind that ordinarily occurs as a result of product defect; and (b) was not, in the particular case, solely the result of causes other than product defect existing at the time of sale or distribution."¹⁴ A plaintiff also may rely on a product's failure to comply with product safety statutes or regulations if such noncompliance renders the product "defective with respect to the risks sought to be reduced by the statute or regulation."¹⁵ In the absence of any Year 2000-specific safety statutes and regulations, plaintiffs likely will look to general statutes and regulations that require products to be functional or operable. Conversely, under the Restatement, compliance with product safety statutes or regulations does not preclude a finding of product defect.

Finally, the Restatement also allows a plaintiff to dispense with the need to establish a reasonable alternative design if the product is "manifestly unreasonably dangerous." In general, to qualify for this exception a plaintiff must demonstrate that the product has low social utility and a high risk of danger. Plaintiffs may find it difficult to invoke this exception in the Year 2000 context because defendants generally will be equipped with convincing arguments regarding the social utility of computer technology.

C. Failure-To-Warn Defects Related To The Year 2000 Problem

The final defect category established by the new Restatement concerns a commercial seller's failure-to-warn. A failure-to-warn defect exists "when the foreseeable risks of harm posed by the product could have been reduced or avoided by the provision of reasonable instructions or warnings by the seller or other distributor, or a predecessor in the commercial chain of distribution, and the omission of the instructions or warnings renders the product not reasonably safe."¹⁶ As with design defects, the use of fault-based concepts such as reasonableness and foreseeability indicates that true "strict liability" does not apply in failure to warn cases.

With respect to Year 2000 cases in which a plaintiff asserts a failure-to-warn claim, the most important battle may be fought over a single issue. Defendants likely will argue that they had no duty to warn, either because the risk of harm posed by the Year 2000 problem was not foreseeable, depending upon the point in time, or, conversely, because the conspicuousness of the risk obviated the need for a public warning. In evaluating foreseeability, courts will undertake a fact-driven inquiry into whether a particular defendant was aware of its product's Year 2000 noncompliance, and the consequential dangers. For their part, plaintiffs will seek to prove that the defendant knew or reasonably should have known of the problem, perhaps by offering testimony from retired or disgruntled former programmers and consultants of the defendant. Plaintiffs are also sure to seek extensive document discovery in the hopes of finding some long-forgotten, incriminating internal company memorandum on the Year 2000 problem.

Regardless of a defendant's awareness of the dangers posed by Year 2000 non-compliant products, the Restatement provides that commercial sellers cannot be liable for their failure to warn of "obvious" or "generally known" risks.¹⁷ Over the last several years, the Year 2000 problem has been widely discussed, industry alerts have been issued, federal and state legislation has been proposed and enacted, and the trade and popular press have written hundreds of warning stories. Thus, a defendant may argue that it had no duty to warn, because plaintiffs who used computer technology, embedded chips,

and software were well aware of the Year 2000 problem. Accordingly, the widespread publicity of the Year 2000 problem, along with commercial sellers' awareness of particular Year 2000 defects, will be key issues in determining whether a defendant had a duty to warn.

A second issue that, although common in failure-to-warn cases, may be less important in Year 2000 cases, concerns the reasonableness of a defendant's warning. Under the Restatement, if a warning was required in the circumstances of the case, a defendant can escape liability only if it provided "reasonable" warnings or instructions. The reasonableness of a warning will depend to a great extent on the defective product's consumer profile. For example, in the Year 2000 context, the purchaser of a non-compliant embedded chip may be quite sophisticated in computer technology, and the threshold for a "reasonable" warning concerning the chip may be quite easy for the commercial seller to satisfy. Nevertheless, this will probably be a non-issue in Year 2000 products liability litigation, because it appears that, at least until very recently, sellers and distributors of software and embedded chips have not included Year 2000 warnings on their products (and doing so likely would not have helped sales).

For the same reason, Year 2000 defendants will likely be unable to take advantage of the protections from liability that the Restatement offers those who place prominent warnings on products. Under the Second Restatement, such a warning could insulate a manufacturer from liability because it was presumed that the user read the warnings and followed its safety guidance. The Third Restatement, however, indicates that warnings are not "a substitute for the provision of a reasonably safe design," and are merely one factor to consider in assessing the defendant's liability.¹⁸ Again, because commercial sellers generally have not placed Year 2000 warnings on their products, they will likely be unable to benefit from these provisions.

In addition to the duty to warn at the time of sale, the Restatement also recognizes a post-sale duty to warn "if a reasonable person in the seller's position would provide such a warning."¹⁹ According to the Restatement, a reasonable person would provide a warning if: "the seller knows or reasonably should know that the product poses a substantial risk or harm to persons or property; and those to whom a warning might be provided can be identified and can reasonably be assumed to be unaware of the risk of harm; and a warning can be effectively communicated to and acted on by those to whom a warning might be provided; and the risk of harm is sufficiently great to justify the burden of providing a warning."²⁰

This post-sale warning requirement is likely to be implicated in many Year 2000 cases. In particular, the reasonableness of the method of communicating the warning may be important. For example, suppose a company that manufactures Year 2000 non-compliant medical devices recognizes that its products pose a substantial risk of harm to persons or property, but does not maintain a mailing list of users and, therefore, posts a warning on its web site. In a subsequent suit, the injured plaintiff might argue that the seller did not act reasonably by posting the information on its web site and instead should have taken some additional effort to warn individuals of the risk. On the other hand, the defendant may contend that posting on a web site is the only commercially reasonable means of notifying users because of the high cost of identifying and notifying individuals. In any event, the question of what is reasonable will be extremely fact-specific.

V. Conclusion

So far, only one Year 2000 case (which was not a product liability case) has alleged actual losses caused by a Year 2000 failure. When products begin to fail in the Year 2000, however, products liability law may be used to help apportion the costs of that failure among distributors and users of non-compliant components, and the new Restatement of Torts (Third): Products Liability may drive judicial decisionmaking.

ENDNOTES

1. Restatement (Second) of Torts § 402A (1965).
2. Restatement (Third) of Torts: Products Liability § 19 (1997) (hereinafter "Third Restatement").
3. Cf. Winter v. G.P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991) (mushroom enthusiast poisoned after eating mushrooms in reliance on information in book sued publisher under product liability theory; court explained that the information in the book was intangible and constituted ideas rather than a product). See also Restatement, § 19 Reporters' Notes to Comment d, which cites similar cases concerning books, magazine articles, standardized forms, and sport event tickets.
4. See Third Restatement § 19(a).
5. The Third Restatement recognizes that some commentators have urged that software be viewed as a product, in part for public policy reasons. See Third Restatement § 19, cmt. d Reporters' Notes. See also Note, Strict Products Liability and Computer Software, 4 Computer L.J. 373 (1983); Note, Negligence: Liability for Defective Software, 33 Okla. L. Rev. 848, 855 (1980); Note, Computer Software and Strict Products Liability, 20 San Diego L. Rev. 439 (1983). In addition, as noted above, the Restatement provides that seemingly intangible concepts "such as real property or electricity, are products when the context of their distribution and use is sufficiently analogous to the distribution and use of tangible personal property." Third Restatement § 19(a).
6. See Third Restatement, § 19 Reporters' Notes to Comment d; Computer Software as a Good Under the Uniform Commercial Code: Taking a Byte Out of the Intangibility Myth, 65 Boston U. L. Rev. 129 (1985).
7. See Linda A. Sharp, Annotation, Computer Software or Printout Transactions As Subject To State Sales or Use Tax, 36 A.L.R.5th 133 (1996).
8. See Third Restatement § 21.
9. See Rockport Pharmacy, Inc. v. Digital Simplicits, Inc., 53 F.3d 195, 198 (8th Cir. 1995) (For purposes of the economic loss doctrine, loss of data constitutes "commercial loss for inadequate value and consequent loss of profit" rather than damage to property).
10. See *id.* § 21 cmt. e.
11. *Id.* § 2(a).
12. *Id.* § 2(b).

13. See *id.* § 2 cmt. d (noting that "the test is whether a reasonable alternative design would, at a reasonable cost, have reduced the foreseeable risks of harm" (emphasis added)). Cf. *Young v. J. Baker, Inc.*, No. 98-01597 (Mass. Super. Ct. filed Aug. 28, 1998) (plaintiff sought declaratory judgment that it did not violate any duty owed defendant when it assisted in the selection, design, customization and implementation of a third-party retail computer software package that was not Year 2000 compliant, in part because making system Year 2000 compliant was not economically viable as there were no compliant mainframe software packages available, and customizing the then-available software packages would be more expensive than the cost of repairs alleged by defendant).
14. Third Restatement § 3.
15. *Id.* § 4.
16. *Id.* § 2(c).
17. *Id.* § 2, cmt. i.
18. *Id.* § 2, cmt. k, illus. 13(2).
19. *Id.* § 10.
20. *Id.* § 10(b). ■

**WILEY, REIN & FIELDING'S
YEAR 2000 PRACTICE****FIRM OVERVIEW**

Wiley, Rein & Fielding is a Washington, D.C. law firm with a diverse national practice. More than 200 lawyers provide high-quality, cost-effective services in over a dozen major practice areas. Our clients are both domestic and foreign enterprises and range from Fortune 500 corporations to start-up ventures. They include both associations and individuals with substantial business interests. The firm takes pride in attentive and responsive relationships with our clients.

The firm is led by Richard E. Wiley, former Chairman of the Federal Communications Commission; Bert W. Rein, former Deputy Assistant Secretary of State for Economic and Business Affairs; Fred F. Fielding, former Counsel to the President of the United States; and Thomas W. Brunner, head of the firm's insurance law practice. Other partners have held high federal posts and many have had distinguished careers in private law practice as counselors, litigators, negotiators, and problem solvers.

THE YEAR 2000 PRACTICE

Wiley, Rein & Fielding has formed an interdisciplinary practice group of experienced attorneys which combines the areas of expertise necessary to address the potential legal risks and liabilities associated with the Year 2000 Problem. As the clock ticks down to the end of the Millennium, the potential costs of correcting the Year 2000 Problem have skyrocketed. Claims arising out of such costs already are being brought at a rapid rate. Only by providing the type of interdisciplinary approach available at Wiley, Rein & Fielding can the expenses of such claims be minimized.

As one of the leading law firms in electronic commerce law, Wiley, Rein & Fielding is uniquely qualified to identify and evaluate clients' potential legal and financial liabilities arising out of the Year 2000 Problem. Wiley, Rein & Fielding has nationally-recognized computer, cyberspace, and high-technology law practices and has been at the forefront of legal activities relating to Year 2000 issues. The Year 2000 Practice Group includes over 30 top attorneys covering each specialty area of practice necessary to assist businesses in strategically addressing the full range of legal issues inherent in the Year 2000 Problem. These areas include: telecommunications, insurance, intellectual property and licensing, computer law, health care, director & officer liability, commercial

litigation, product liability, employment, corporate and tax law, government contracts, tort liability, aviation, and lobbying.

Drawing on these areas of expertise, attorneys in Wiley, Rein & Fielding's Year 2000 Practice Group have lectured on client issues involving the Year 2000 Problem in programs across the country, including chairing Mealey's Year 2000 Conferences in Phoenix, Arizona and Arlington, Virginia. Several have published articles and tutorials regarding various aspects of the Problem, discussing categories of risks and proposing methods to minimize a company's potential Year 2000-related liabilities. In addition, Wiley, Rein & Fielding has hosted several well-attended cyberspace seminars that focus on specific areas of concern for businesses in managing the Year 2000 Problem. As a result, Wiley, Rein & Fielding attorneys are well positioned to assist companies in addressing their Year 2000-related liabilities.

THE YEAR 2000 PROBLEM

Essentially, the Year 2000 Problem stems from the simple fact that most computer software is not prepared to recognize the change in date from the year 1999 to the year 2000. This is partly a result of an early decision to conserve what was then scarce and expensive memory storage capacity by programming computers to operate with date fields that would use only two digits to represent a year, assuming that the first two digits were "19." Computers programmed in this manner will recognize "00" as the year 1900, not the year 2000. Therefore, on January 1, 2000, the computer will read the date as January 1, 1900. The problem also arises out of similar coding decisions with respect to many modern microprocessors or "embedded chips."

Unless corrective measures are in place well before December 31, 1999, computer operations will experience potentially critical breakdowns in operations, such as the miscalculation of date-sensitive data or complete software malfunction. Simply put, every piece of equipment suffering from the Year 2000 Problem could go haywire. Not only computer software may be vulnerable; many of the billions of embedded chips used in a wide range of equipment from traffic lights to defibrillators may be affected. In addition, operations with forward-looking date sensitivity, such as reservations, renewals, and expiration dates, may face system failures well before January 1, 2000.

Also in play are two factors that may both exacerbate the Year 2000 Problem and complicate its resolution. One is that the year 2000 is the first turn-of-the-century leap year in modern times. The second relates to the programming practice of utilizing "99" as a code for a different operation, causing date fields incorporating that figure to be unintelligible to some computers. Computers programmed in this manner will face problems similar to those of the Year 2000 Problem, only sooner.

The Year 2000 Problem is not just a technology issue about fixing computer code or buying new software. It is about charting a course to protect your business from

unnecessary exposure to Year 2000 risks. This includes protecting directors and officers from liability, anticipating shareholder derivative suits, revising and enforcing contracts with suppliers and customers, avoiding product liability, assuring that fiduciary and other duties are fulfilled, meeting regulatory obligations to deal constructively with potential Year 2000 liability issues, and providing necessary disclosures under securities and other requirements. These issues require attention and commitment from the highest levels of management. Failure to address the problem adequately will be costly.

Year 2000-related problems will not wait to appear until January 1, 2000. Rather, many problems and their attendant legal liabilities are already here. A number of businesses already have experienced real operating failures relating to the Problem, and many more can be anticipated in the near future. In addition to technical problems, businesses also must plan for the effects on staffing, resources, and funding which are required to address these issues, as well as a host of legal challenges. As the Millennium draws near, more and more companies are beginning to proactively identify and manage their potential liabilities arising from the Problem. All functions of a business that rely in any way on software will be affected to a greater or lesser degree.

OUR APPROACH

We recommend that all businesses take at least some corrective action now to avoid the pitfalls of the Millennium Bug. Members of the Year 2000 Practice Group recognize that each client's approach to resolving their Year 2000 crisis will vary. Therefore, we utilize a multifaceted approach designed to develop an effective remedial plan based on each individual client's needs. The first step of any such plan is to conduct a comprehensive legal audit in an effort to identify all areas potentially affected by the Problem, with the ultimate goal of implementing appropriate legal and business strategies to avoid liabilities and manage potential litigation.

To that end, Wiley, Rein & Fielding assigns an interdisciplinary team of attorneys to develop an effective remedial strategy plan based on each client's needs. The Year 2000 audit team will focus on the following issues, among others:

- Identifying potential areas of legal liability and of recovery from others;
- Addressing existing contractual and quasi-contractual relationships with suppliers and customers;
- Developing plans for responding to the consequences of possible failures;
- Advising on pending government regulations including federal and state Y2K disclosure requirements;
- Assisting in negotiations with software suppliers, equipment manufacturers and others;

- Conducting any Year 2000 litigation, as it arises;
- Guiding management and the Board of Directors in taking proper, fully-documented steps to respond to the Year 2000 challenge; and
- Assuring that shared and interdependent computer systems are rendered compliant.

Wiley, Rein & Fielding's Year 2000 audit teams work closely with the client's executive, legal and technical personnel to ensure a comprehensive and complete review of risks, exposure, and compliance issues.

Wiley, Rein & Fielding is committed to marshaling its interdisciplinary resources, broad substantive expertise and wealth of attorneys recognized as authorities on Year 2000 issues to achieve success for its clients. We look forward to working with you to develop, evaluate and implement your Year 2000 program.

As the number of legal developments surrounding the Year 2000 Problem grow, Wiley, Rein & Fielding will continue to update and educate businesses regarding the potential risks of, and possible solutions to, the Year 2000 Problem. In particular, Wiley, Rein & Fielding is tracking important Year 2000 developments on its Year 2000 website, located at <www.wrfy2k.com>.

* * *

If you have any questions or would like any additional information, please contact a member of Wiley, Rein & Fielding's Year 2000 group or any other attorney at the firm. We welcome the opportunity to discuss any matter of specific concern to you or to tell you more about our practice and our capabilities.

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PROFESSIONAL SUMMARY

Partner in Wiley, Rein & Fielding's litigation and insurance practices, and Co-Chair of the firm's Year 2000 practice. Practice encompasses a wide range of commercial matters involving litigation and counseling in the area of insurance coverage and bad faith disputes, emerging Year 2000 issues and other cybertechnology areas, including a variety of matters involving professional liability and general liability insurance policies, representing insurers in coverage matters and defending policyholders in underlying cases. Has litigated cases in over 35 states and has been first-chair trial counsel in numerous cases, including several recent insurance coverage actions. Chair of the DRI Insurance Coverage Professional Liability Subcommittee. Editor of *Coverage*, a publication of the ABA Committee on Insurance Coverage Litigation. Expert witness in bad faith litigation. Law school lecturer and frequent speaker at conferences and seminars on emerging insurance coverage and Year 2000 liability issues.

YEAR 2000 PUBLICATIONS

"First Cases Foreshadow Later Litigation: Reading Early Returns" *The Legal Times*, at S34 (Jan. 25, 1999 Year 2000 Special Report)

"Year 2000 Litigation May Be The Testing Ground For The New Restatement Of Products Liability Law" *Mealey's Year 2000 Report*, January 1999

"Insurance Coverage For The Millennium Bug" *Mealey's Year 2000 Report* 1, at 55 (Feb. 1998)

UPCOMING YEAR 2000 SPEECHES

Congressional Testimony

"The Impact of Litigation on Addressing the Year 2000 Problem"

Before the Science Committee's Technology Subcommittee
(March 9, 1999)

"Insurance Coverage for the Year 2000 Problem"

Defense Research Institute Excess & Reinsurance Seminar
New Orleans, Louisiana (April 14-16, 1999)

"Establishing Coverage Criteria for Y2K Claims Under CGL Policies"

IQPC Y2K Insurance Exposure Conference
Chicago, Illinois (April 27, 1999)

Mealey's Year 2000 Insurance Conference

San Francisco, California (July 15-16, 1999)

WALTER J. ANDREWS
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YEAR 2000 SPEECHES DELIVERED

"Year 2000 Liability and Coverage Issues"
American Bar Association Insurance Coverage Litigation Committee Midyear Meeting

"Year 2000 and Intellectual Property Insurance Coverage Issues"
American Bar Association Tort & Insurance Practice Mid-Winter Meeting

"Y2K Liability"
Self-Insurance Institute of America Ninth Annual Third Party Administrator Executive Forum

"How to Prepare in 1999 for the Year 2000 Problem"
Luncheon Program sponsored by Wiley, Rein & Fielding

Webcast Program: The Year 2000 Information Readiness and Disclosure Act
Sponsored by Information Technology Association of America

"Y2K Compliance: Avoiding the Pitfalls"
American Trucking Associations Annual Meeting

"The Y2K Problem: Compliance & Certification"
Information Technology Association of America (Program Moderator)

"Insurance Coverage Under CGL Contracts for Year 2000 Losses"
Mealey's Year 2000 Insurance Conference (Program Co-Chair)

"Legal and Financial Implications of the Year 2000 Problem for Steel Companies"
American Iron and Steel Institute Annual Meeting

"Year 2000 Liability and Insurance Issues"
Alliance of American Insurers Legal Committee

"How to Manage the Risk Through Insurance"
Year 2000 Computer Liability Conference, Technology Transfer Institute

"Year 2000 Millennium Bug Legal Liability and Risk Avoidance"
National Professional Communications Company Conference

"Year 2000 Liability Issues"
National Association of Independent Insurers' Underwriting Seminar

"Year 2000 Errors & Omissions Insurance Coverage Issues"
Mealey's Year 2000 Insurance Conference (Program Co-Chair)

"The Year 2000 Problem and Insurance Coverage Issues"
Wiley, Rein & Fielding Cyber-Insurance Seminar

Program Chair
ABA Section of Litigation Insurance Coverage Litigation Midyear Meeting

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March 9, 1999

FACSIMILE
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Rep. F. James Sensenbrenner, Chairman
Committee on Science
House of Representatives
2320 Rayburn House Office Building
Washington, D.C. 20515

Re: Disclosure of federal funding related to Congressional testimony

Dear Chairman Sensenbrenner:

On March 9, 1999, I appeared to testify at a joint hearing on "The Impact of Litigation on Fixing Y2K," held before the Subcommittee on Technology of the Committee on Science and the Subcommittee on Government Management, Information and Technology of the Committee on Government Reform.

Neither I personally nor to my knowledge the law firm of Wiley, Rein & Fielding have received federal funding in support of the subject matter of this hearing.

Sincerely,



Walter J. Andrews

Chairwoman MORELLA. Thank you very much, Mr. Andrews.

That was excellent testimony on the part of all of you. As Hump-ty Dumpty said in *Through the Looking Glass*, "it fills my mind with ideas." So we will start the questioning. Again, each of us will try to stick to five minutes of questioning, and then come back maybe for a second round, or however number of rounds would be necessary.

I wanted to probably start off with picking up on what you had said, Mr. Andrews, about the cost which had been repeated. The fact that it may well be \$1 trillion, and that would be ultimate litigation. It may cost \$1 trillion, assuming average legal costs and a five percent failure rate and all of the various kinds of estimates that indicate that it would be pretty close to that in litigation.

Then the question of is year 2000 litigation inevitable? Well, when you note that some litigation appears to be inevitable because the year 2000 problem, which stems from the Gartner Group estimate that perhaps 50 percent of the companies with the year 2000 problem will not become fully compliant by year 2000, by January 1st in the year 2000. The reason that so many companies will fail in their year 2000 corrective measures is that one, some of them are starting too late. Secondly, they may not be devoting sufficient personnel and funds to this remediation. Thirdly, there may not be enough trained programmers available in any event to fix all of the software code requiring correction. Not enough time and resources will be devoted to the testing phase, which could be the most expensive, quite frankly, and time consuming facet of it for many companies. Even if a particular company becomes fully compliant, its systems could become contaminated by data or software that is supplied by the other third parties with which they interact who have not become compliant.

Also, the city or the geographic area in which the company has its offices may not have year 2000-compliant telecommunication and electric utility systems, resulting in infrastructure failures, which negatively impact on the economy.

Well, all of that being said, I have tried to touch on why so many companies would probably not be compliant, see whether you agree with me, what the cost could well be. And we are here to talk about whether there are some remedies to it.

So I wondered if any of you have come up with, in addition to your testimony, in this short time what can be done? For instance, there has been discussion about whether or not there should be a litigation cooling off period that would postpone the filing, for instance, of Y2K litigation for let's say 30 to 90 days, depending upon whether the defendant agreed to fix the problem and made attempts to fix the problem, and unduly limit a plaintiff's legal rights.

Perhaps we will start off with responding to that for I guess any or all of you briefly, and any of the other comments that I made about the problems of the situation we will be in with lack of compliance, and why. Would anyone like to start off?

All right, Mr. Andrews, we will start with you.

Mr. ANDREWS. Let me touch on the first comment you were making in terms of whether there is going to be a failure and why. I think all the reasons you suggested are quite true. In addition,

there is sort of a more pervasive, almost more innocent reason. I have been involved in computer programming in one way or another for 25 years, and also have been chair of our firm's own internal technology committee for several years. I can assure you that even with the best efforts and the best resources and the best staffing, and far ahead planning and thought being given to how to approach this, it is almost inevitable that any software conversion or change will end up with a certain number of bugs, as they call it, or glitches or failures. What we are talking about now is having the entire economy change at once. So it is almost inevitable that there will be a series of failures. I think Professor Effross talked about the domino effect, the cascading effects, so that those failures, even if small in isolation, become much more magnified when they are affecting all the others who also have their own systems.

As you pointed out with the inter-operability issues, they will affect others. The data will be sent to other systems. If the data becomes corrupt, it will corrupt the other system's data. In terms of testing, as you point out, it is very hard to test when you have inter-operability issues. We now have a globally interdependent computer-generated, computer-driven economy. So I do think there will be problems, despite the best efforts. I think that should be kept in mind. It's not just a matter of companies or individuals not wanting to see these problems fixed.

Chairwoman MORELLA. So you therefore see the litigation is probably going to be inevitable?

Mr. ANDREWS. I think a fair amount of litigation in today's economy, with today's problems, is inevitable. I think what we would like to see avoided though is the creation of additional remedies, when they weren't there to begin with. I mean parties can, as I have advised in my testimony and with clients, can reach a contract, and determine by that contract what their respective rights are. Those contract rights should be the paramount concern. They should not become a new tort action. Should not tortify, if you will, contract obligations and rights between parties.

Chairwoman MORELLA. I am going to let each of you just give one comment maybe in response to whether we could use a cooling off period, since litigation appears to be inevitable, and then recognize my colleagues.

Mr. Nations.

Mr. NATIONS. The problem with the cooling off period was indicated in the Produce Palace International case that you referred to, that the gentleman with the cash register that didn't work. He testified in the Senate on this. He indicated that the day his cash registers failed, that immediately he started calling the computer programming company and trying to get them in. He said he called about 150 or more times. Over a period of two months, he got no response. And over that two month period, he lost hundreds of thousands of dollars, and he lost his customer base.

That is the problem with the 90-day cooling off period, is that this is going to be business versus business litigation. A lot of the plaintiffs are going to be small businesses such as the Produce Palace International. Can they afford 90 days without the computers, in his case without his cash registers working? Can they afford 90

days of waiting in order to have something done about their problem?

I submit to you that there is no real purpose to be served by the 90-day cooling off period. If you see where the legislation has been filed, I mean where the litigation has been filed, the class actions, for example in the Courtney case, within 60 days after filing the class action in Courtney, the matter was resolved. The agreement had been reached. But it was reached only after the lawsuit was filed. They tried for more than 2 months before filing suit, got absolutely nowhere, filed the lawsuit, and the matter was resolved within 2 months after that. So the lawsuit was what spurred the resolution and the class action nature of it.

Chairwoman MORELLA. You know, with Produce Palace though I think that if they had had alternative dispute resolution, they might have been able to resolve it with saving money even faster. Would you agree? So you see merit in that? I know we are getting into another facet of it.

Mr. NATIONS. I think alternative dispute resolution is an excellent idea in Y2K cases. I think it is an excellent idea in all cases, frankly, so long as it is not binding arbitration that does away with your right to trial by jury. As long as it is mediation, alternative dispute resolution, there is no problem with that. We use it very, very effectively in Texas for all types of cases. It has been a real blessing, actually, to relieve the clogged nature of our courts.

Chairwoman MORELLA. Ms. Lundberg, do you want to comment?

Ms. LUNDBERG. Yes. I agree very much with what Mr. Nations has said. In particular, if a system that is failing because of a Y2K failure is a mission-critical system, my company could be out of business in a matter of weeks. There isn't time to really provide that grace period.

While I really like the idea of the grace period, I think it has got to be pretty well contained, and there has got to be some limits around which kinds of systems. I don't know—that is getting too complex maybe, but which kinds of systems you could apply it to. Because if it is a system that—if my system is down for 2 days, you know, I am going to lose half of my business, then that is not going to be acceptable.

Chairwoman MORELLA. Mr. Effross.

Mr. EFFROSS. I would just add to what my colleagues on the panel have said, which I completely agree with. Look at it from the point of view of the business which is trying within those 60 days frantically to fix things. First of all, this may not be the only problem that is being brought to their attention in which the 60-day clock is now running. It may not be the only product which they are trying drastically to fix. I mean for instance, I know it is way too late in my life now to ever be able to personally to run a 4 minute mile, if I ever could. But if somebody told me, well you have 60 days to give it your best shot, I couldn't still do it.

As well, another issue to look at is around the time these suits start surfacing, there are probably going to be problems being experienced by the defendants themselves in their own Y2K dealings with other entities, who are disappointing them. And who knows what is going to be happening on a larger scale. So if I had to figure out how to run a 4-minute mile at the same time as I was plan-

ning to get married, and moving my house, and buying a new car, I wouldn't ever be able to do any of those well.

I would just add a final point on alternative dispute resolution. I think that is a good idea. I have also seen a number of references and recommendations made to it in some of the literature. I really would recommend that if I were counseling a potential defendant, because I think one of the things defendants are going to have to worry about in these suits is I don't think it is all that tough for a jury to understand the year 2000 problem. I think in 5 minutes a good lawyer could clue them in as to what the basic problem is without any special training on their part.

I also think there are no scientific issues here. There may be issues of what is the industry standard, what were people shipping, what was everybody expecting. There is no issue of tobacco: was this dangerous, was it not, when did the studies start surfacing. There is no issue of DES or asbestos: when was there a scientifically shown problem here. From day one, or at least from 1960, as Mr. Nations has pointed out, it was recognized within some elements of the software community, this software has essentially an expiration date on it.

Chairwoman MORELLA. I must give Dr. Donohue an opportunity. He is salivating there.

Mr. DONOHUE. I just think I would make three very quick comments. First of all, this legislation does not envision eliminating the right to sue. It contains the right to sue for damages, full damages, for physical loss of property or person, and for any reasonable matter.

What it constrains is the gold digging opportunity to collect massive amounts of punitive damages on a class around something that is far more complicated, as the members of the panel are beginning to hear, just by listening to the testimony.

Second. I think it is important to begin to think about the scope of dollars we are talking about. Invite Alan Greenspan up here, and ask him what happens if there is a trillion dollars worth of lawsuits filed. Never mind the money for a minute. Just think of the distraction from an economy that is leading the world, and we are trying to keep moving, by the way, based on a technology system that has given us probably two or three points more on our productivity in this country than is actually recognized.

Third. I think it is very, very important that we maintain some consistency in our arguments. Our colleagues from the trial bar said that we have an excellent rule of law and a common code in which we can advance our arguments about who is liable and at what amount. On the other hand, in a lot of the suits, they are going through the states and trying in legislation successfully, to eliminate the assumption of risk and the need to produce actually injured persons as opposed to statistically injured persons.

Only imagine when they use these factors in the Y2K issue. We are talking about a circus that is going to impede the national economy. All we are saying here in this legislation, full suits for damages. Nobody gets away. Reasonable accommodation on time, on alternative dispute resolution, and not a gold mining on punitive damages. There is some common sense to this. The Congress

is showing some leadership. We ought not be diverted from what we are trying to do to fix a significant worldwide problem.

Look, I am willing to say that we go back to ground zero on every other tort reform issue. This is not a product, a single product. This is not a single service. This is a globally integrated technology system that I suggest nobody in this room fully understands its integration. We ought to be very, very careful.

Chairwoman MORELLA. Thanks, Mr. Donohue.

I am going to now turn to and recognize the co-chair of this committee hearing, Mr. Horn.

Mr. HORN. Thank you very much.

Let me ask you across the board here, how many have had a chance to read the draft bill? Okay, most of you have.

Let me start with you, Mr. Andrews. If there is one thing in that draft bill that you would like to eliminate, what is it?

Mr. ANDREWS. Well, I suppose I would go even one step further than Mr. Donohue suggests, and continue to eliminate all punitive damages. I don't see how punitive damages becomes an issue of public importance with respect to this problem.

Mr. HORN. Okay. Mr. Nations, what is the one thing you would eliminate?

Mr. NATIONS. The one thing I would eliminate is the proportional liability because of the necessity for joint and several liability to be the law in this particular Y2K litigation because of all the foreign vendors involved.

Mr. HORN. Ms. Lundberg.

Ms. LUNDBERG. The one place that gave me real pause, and I am not sure I am reading the law right here, but there seemed to be a limit on economic damages unless it was written into the contract that those damages would only be paid if it was written into the contract that Y2K compliance was guaranteed or that the monies would be paid if there was a Y2K failure. That concerns me.

If we are talking about a situation—that works maybe for a technology provider, but that concerns me if we are talking business-to-business. If a critical supplier of mine can't deliver the products and services that I need to do my business because of a Y2K failure, and we hadn't anticipated it when we wrote that contract, that that might be a problem.

Mr. HORN. Professor Effross.

Mr. EFFROSS. I haven't read the bill carefully enough to give as intelligent a response as I would like to, but I would say as a gut reaction, the elimination of proportion—or the institution of proportional damages bothers me, because I think there is going to be a number of issues there that will be fought over endlessly.

Mr. HORN. What are some of those issues?

Mr. EFFROSS. For instance, how are you going to—if we are talking say about dividing liability between an internet service provider and a software manufacturer, many of these products work in conjunction with each other. So how are we going to start figuring out, is it market share? Because we might know as opposed to some of the tort cases which particular person produced it or group produced this piece of software that is being used. Are we going to be dividing across different applications or within one set

of applications? How do you go by when to figure out in either of those tests, when the appropriate share should be measured?

I am not entirely sure that is something I feel comfortable with, without looking at it a lot more carefully, which as I admit, I have not done.

Mr. HORN. Mr. Donohue, any part you would want to give up?

Mr. DONOHUE. No. What I would like to do is shrink the time between the talking and the acting, so that we can give some relief to all people, lawfirms, companies, governments, that are trying very much to solve this problem.

If I may say one thing, I would add, to really get people to move in the right direction, I would make the Government as liable as the companies if they don't perform. You have a serious problem. Your Committee has led the way in pressing our Government to bring its own systems in compliance.

Mr. HORN. Thank you.

Mr. DONOHUE. We're doing a lot of praying on it.

Mr. HORN. As I have moved around the country, I find some of the general counsels of various firms of various size have advised the chief executive officer, "Don't say a word on this, Chief. Then they can't sue you."

If you were the general counsel to that firm, do you think that is good advice, Mr. Andrews? I am going to leave this for the lawyers over here.

Mr. ANDREWS. I think that I am going to be careful here, since I might have given that kind of advice myself. I think that truthful measured statements can only help because you want to make appropriate representations so that you have not hidden the ball. But I think you do have to be careful about going too far and admitting things that you don't have to admit.

So I guess that's a lawyer's answer, but I think that there has been some efforts to protect with safe harbor, with the Information Readiness Disclosure Act, but I still think that there is certain exposure out there that if misstatements are made. I think the problem is that—

Mr. HORN. Okay. My time, I see Mrs. Morella has it at 40 seconds.

Mr. Nations. Okay. She will give me a minute longer.

Mr. NATIONS. I think that advice would not be necessary to a CEO because this litigation is going to be based on breach of implied warranty, breach of contract. It is going to be based on very specific things, not on what the CEO says or what the CIO says or CFO says.

Mr. HORN. Ms. Lundberg, do you have a license as a lawyer? You are an excellent editor. I love your magazine.

Ms. LUNDBERG. Thank you.

Mr. HORN. Professor Effross.

Mr. EFFROSS. Although I don't practice criminal law, the one lesson in criminal law I have learned from watching NYPD Blue over and over, which I think is totally applicable to this is, don't talk without your lawyer there or having talked to you first. That is what I would tell my client.

Mr. HORN. I watch Ally McBeal, so I don't get the same advice. [Laughter.]

Mr. Donohue.

Mr. DONOHUE. Mr. Chairman, it's good legal advice. It's lousy business advice.

Mr. HORN. Okay. Let me ask one last question here. That is, should there be a specialized court set up if there were a federal statute and you in some circuits could find certain judges that would be used to this type of decisionmaking? One could also say in a lot of circuits around America, the state circuits, even though they have all the uniform laws, commercial aspects in their statutes, all 50 states, do we really need a specialized court to deal with this?

Do you have a feeling on that, Mr. Andrews?

Mr. ANDREWS. I don't know whether we need it or not, but I think the practicality of the matter is there is just no way we could realistically get one ready to go so that people could know how to deal with it in a timely fashion. I think it is just impractical at this stage.

Mr. HORN. Okay. Mr. Nations.

Mr. NATIONS. The answer, sir, is that we do not need specialized courts because this is going to be not technologically based lawsuits. This will be breach of implied warranty, breach of contract, the type of business litigation that our courts handle every single day. We have no need for specialized courts to handle this, sir.

Mr. EFFROSS. I would agree with Mr. Andrews and Mr. Nations. I don't think that the technological issues are so difficult that courts and juries can't understand them. I think the law is really just building on what is already in place.

I would add to what Mr. Nations said, as my statement points out. There is also a much wider variety than just contract menu of liability issues, from particularly several very enticing tort entrees.

Mr. HORN. Mr. Donohue.

Mr. DONOHUE. Let the record show that the trial lawyers and the business community agree. We do not need a specialized court.

Mr. HORN. I thank you all.

We have a conference going on, so I am going to have to leave right now, and leave it to—

Chairwoman MORELLA. I now turn to Mr. Barcia for his questioning.

I want to point out first of all, that any member who is not here or who is here and wants to submit questions, we will submit them to you. Is that all right with the panelists? Thank you.

Mr. BARCIA. Thank you, Madam Chair. I would direct my first question to Mr. Andrews.

Since your lawfirm has been working on the year 2000 liability issue and counseling your clients on minimizing their legal and financial liability exposure, in general terms, what types of clients are seeking this assistance? For example, if you can quantify for us are they large companies, small manufacturers, or service providers? In your estimation, are large companies better prepared for the year 2000 problem? Is there really a need for Congress to react of course to address this problem in terms of Y2K litigation and liability issues?

Mr. ANDREWS. I think the types of clients that come to us run the gamut. I think that they are illustrative of Chairwoman Morella's comments, that this is an across-the-board issue. We have got large companies. We have got small companies. We have got people in different industry segments. We have got radio broadcast stations. We have got drug companies. We have got steel companies. We have got hospitals. We have got insurance companies. The whole gamut. I think everyone is waking up to this. We are trying to take it seriously. Everyone has something at stake here, although obviously the types of issues involved differ greatly from a trade association to a radio station to a hospital. But they all have issues and they are all taking it seriously.

Mr. BARCIA. Thank you. I think I will limit, since we have a number of members here also who want to ask their questions.

I would like to direct this question to Mr. Donohue. Just briefly, if you could, Mr. Donohue, comment from your perspective with the U.S. Chamber of Commerce. Has your association done any assessments to date among its membership, estimating the potential cost of liability, and also the magnitude of the problem in terms of your membership? Like Mr. Andrews, I am sure you will confirm that it is kind of across-the-board in terms of small business, manufacturing concerns, hospitals, and insurance companies, financial institutions. But would you care to comment in terms of the possible impact if we don't act in terms of cost of liability?

Mr. DONOHUE. Congressman, first of all, it is across the board. It is a small farm, it's a large pharmaceutical company, it's a hospital. As Mr. Andrews indicated, it doesn't matter what your business is, because after you look at all your own activities, you have to figure out who you are linked up to, whether it is your bank or it's your supplier, or it is somebody downstairs that is in your computing program that altered a program 20 years ago and you never knew it. It is a very difficult issue.

But the magnitude of this, as the members of the panel have pointed out, have come out in a lot of studies. Are they talking about \$1 trillion or \$500 billion or \$1.5 trillion? I don't know. It is a hell of a lot of money.

But the other thing is, it is going to be a lot of cases, and it is going to clutter up the situation until we find a way to handle it. But if we can handle it on a simple business basis, what are the contract requirements, and stay out of the punitive business, this thing will be done much better and much quicker, and to the satisfaction of all, except maybe a few.

Mr. BARCIA. Thank you, Madam Chair. That concludes my questions. I appreciate those responses.

Chairwoman MORELLA. Thank you, Mr. Barcia.

Now I am pleased to recognize Mr. Davis from Virginia.

Mr. DAVIS of Virginia. Thank you.

Let me ask Mr. Nations if a company, let's say a small dry cleaners or someone who bought a system years ago when the state of the art was perhaps that you just stored two digit dates, they make a very good faith effort to fix it, spend a lot of money—in my wife's gynecology practice, they spent \$20,000 to become Y2K compliant. If they have made a good faith effort, why should somebody be able to come and get punitive damages against them? You ought to be

able to get your actual damages, and the legislation would allow it. Why should you be able to get punitive damages in a case like that?

Mr. NATIONS. The answer is that they can't get punitive damages in a case like that.

Mr. DAVIS of Virginia. Okay.

Mr. NATIONS. The standard for punitive damages, and it has been tossed around here as if this is just something you get in every lawsuit. The standard for recovery of punitive damages is extremely high. It is a very difficult proof to make. Secondly, very, very seldom in breach of contract cases do you have any punitive damage awards. There is no provision for it.

Mr. DAVIS of Virginia. And what this legislation does is it says if you have made a good faith effort, you don't get to come in under a tort theory and get punitive damages. So we are in agreement on that I think.

Let me ask Mr. Donohue, could you talk to us why some of the small businesses are not taking the necessary steps to solve the Y2K problem? Is it affordability? Could you go into that?

Mr. DONOHUE. Well, there is a whole raft of reasons. First of all, and I say this respectfully, is the question of ignorance. You know, we have tried very hard to alert people. They are looking at, you know, they are busy as you know. In your experience, Mr. Davis, when you are running a small business, that is what you are doing. Second, the issue of dealing with connectivity. Many of them are hooked to their banks. But many of them are hooked to the major companies who are their suppliers or to whom they supply. Third, it's fear. The fear of the unknown, the fear of lawsuits, the fear of what comes next.

I think it is probably true that there won't be a great deal of lawsuits against the dry cleaner. I mean what value can you get out of them other than to get your suit back when it was shipped to Asia or something.

Mr. DAVIS of Virginia. But I will tell you, if they damage your suit, you want to go after them.

Mr. DONOHUE. In that instance, I think you get them back. I am not worried about punitive damages against the dry cleaner in Montgomery County. But I am worried about what happens to who they are hooked into and what they do to larger companies, perhaps the person that does the wholesaling part of that and cleans the shirts.

I just think what this bill does—you know, this bill wreaks of common sense. It says if you have an actual loss, you can go sue them and get the money. It says we want to limit though where this goes. I think it makes a lot of common sense.

One other thing I am encouraged about with small companies. Many of them have new computers, because small companies are often new, there is a lot of turnover in the business. I am encouraged by that. I think that is one thing that will prevent—they will have fewer problems here than we will have other places around the world because of that.

Mr. DAVIS of Virginia. It's true. Like some states like Nevada have almost made Y2K failures an act of God, where the consumer gets nothing. So the bill that we have in this case allows people to

get their damages. But what it does try to prevent is take it that next notch over. And also, in the class action suits, it does have a notice provision, where if you are suing on behalf of me or somebody else, I get to know about it ahead of time. It strikes me as pretty reasonable.

I wonder if you can talk about the proportional liability issue, Mr. Donohue, because that has been—a couple of the panelists, that is the most offensive part of this legislation, if you can discuss that.

Mr. DONOHUE. Well, if we look at proportional liability, we deal with the reality that has become very prevalent in our society of joint and several liability. When I ran the American Trucking Association, and Mrs. Morella knew a lot about what we were doing in truck safety. I mean you could park a truck behind a diner and go to sleep, and there's an accident out front between a series of cars, and a tire rolls off and hits the truck. The truck is the only person with deep pockets, and they end up paying everybody else. I mean joint and several liability has been a fascinating part of our legal system in recent time.

What we are saying here, we can't take the act of a small company that really loused up everybody else's system, and then go to somebody that was connected to them once a year for a delivery and get them to pay the whole deal.

I know that might upset the purest in the legal profession, and I respect that very much. By the way, this whole country and our industry depends on 800,000 lawyers that keep the business of this country together. But I think we need to be realistic because if we take away the joint and several to the extent that it has been applied, we are going to reduce the lawsuits and the amount of money. That trillion dollars worth of lawsuits is going to go down in a big hurry, because when there's not somebody with the big deep pockets, you don't find so much time spent on the matter.

Mr. DAVIS of Virginia. Let me just say I find all of the witnesses have really added to this. I appreciate everybody doing it.

What makes this so different from every other type of activity out there is the inter-connection, if you will, between the small guy, and one person who fails along the way can in fact bring down the whole system. You can test most of this. You can go through your good faith effort. But if somebody gets hurt at the end, somebody who has done nothing wrong, who has tested, who has paid a lot of money to get their system up, can actually be held liable unless you alter the current rules.

I can't believe that people who wrote the UCC really understood what the information revolution would mean in terms of some of these items. It is an opportunity to look at that.

But one thing I like about this bill is it is very, very narrow. It doesn't try to change your tort law for medical malpractice or anything else. In fact, if you are injured, you are outside of this act entirely. Personal injuries because of Y2K, current law applies. But because of the inter-connectivity of these issues, it does carve out a cycle and recognizes the fastest growing part of this economy are technology companies and the like. We should cut them, you know, treat them a little bit differently, and allow them—to encourage

them to fix the problem, because if they don't make efforts to fix this problem, they don't come under the purview of the act.

Secondly, if they do fix it, the consumer is protected. If there is any problem, the consumer is protected. But finally, we are not going to tie this down with a lot of lawsuits that you file just to try to make somebody settle. Our companies who are carrying this economy right now are going to be able to put their assets into worker training, be able to put their assets into further innovation so we can stay first in a global economy.

I think that is the purpose of this, but I would welcome any constructive comments anyone has as this legislation moves its way through the Judiciary Committee. We will be holding hearings on this. We expect it to go to the floor sometime in the next couple months. We would like to work with everybody. I think everybody had some comments and elements to their testimony. We appreciate it.

Thank you. I yield back.

Chairwoman MORELLA. Thank you very much, Mr. Davis.

I am now pleased to recognize Mr. Turner.

Mr. TURNER. Thank you, Mrs. Morella.

Mr. Andrews mentioned in his slide the estimate of \$1 trillion in potential litigation costs, judgments, I assume. Where does that number come from?

Mr. ANDREWS. I think the particular number was one that Chairman Horn had mentioned from the Gartner Group. But it is in range of numbers that lots of different consulting groups have thrown out there, from \$200 or \$300 billion, to \$2 or \$3 trillion. I don't think anyone can guess for sure.

I think the point of my slide there was to show that whatever that number is, it is likely to be much greater than the amount of litigation cost of the asbestos and SuperFund or environmental litigation, which clearly kept a lot of lawyers busy and a lot of companies spending legal fees.

So whether it is \$100 billion or \$1 trillion or \$2 trillion, it is a lot of money.

Mr. TURNER. Well, how do you know that though? I mean what I am looking for—you know, we have heard that \$1 trillion number thrown around. It looks like if that is a meaningful number, somebody could produce a study or something that has produced that.

Mr. ANDREWS. I think the study that Chairwoman Morella referred to was the Gartner Group, and estimated based on a five-percent failure rate and the average cost of litigation today that would come up to about \$1 trillion. Again, it is just an estimate because no one can say for sure how many failures we are going to have. It is possible we won't have that many. I think the fact that you have got over 55 lawsuits today, 300 days before year 2000 though is an indication there will be plenty of litigation over this issue.

Mr. TURNER. Well, you know, Chairman Horn and I have had extensive hearings regarding the status of Government agencies in Y2K compliance. To be quite frank with you, after hearing all the testimony from all of our Government agencies, I am not really sure yet how big a problem we are going to have. It disturbed me somewhat to have us talking about these big numbers when no-

body seems to have produced any documented report of any type to base any number on.

To simply say that there are going to be lawsuits, obviously there will be some. There have already been 55. But I think in dealing with this entire issue, the thing that disturbs me, and I must plead to a bias. I come from a rural district. We don't have any software manufacturers. We don't produce this problem. A lot of my small businesses use computer software and may be the subject of software failures, but I don't represent people who produce it. So I am very sensitive to—

Mr. ANDREWS. So you may be representing more of the plaintiffs than the defendants in this.

Mr. TURNER. May very well be.

Mr. ANDREWS. I think for the reasons that I discussed with Chairwoman Morella, there is likely to be unfortunately a number of failures. We don't know how many. I hope you are right that there isn't a big problem. But it is hard to imagine there won't be some problems. If there is some problems, it is hard to imagine there won't be some litigation.

Mr. TURNER. Let me approach it a little different way. Since I am obviously not convinced as to the scope of the problem that we are going to have, and let's not talk about Y2K. Let's say that a major software manufacturer produced a piece of software that couldn't read zip codes that began with 7. Now if that occurred and a major software company created that problem, why would I want to impose the limitations on liability that are in the proposed legislation to protect that particular software manufacturer against plaintiffs like I may very well represent in a rural district?

Mr. ANDREWS. I am not sure that you would. I think that the idea, and I think Mr. Donohue could speak to the legislation much better than I can. I can speak more to the liability that we are witnessing. I think that the difference of any is that here we know we have a large-scale problem, and we are trying to see I guess if there are ways that either through litigation avoidance, business client counseling, or contract negotiation, we can avoid some of that litigation ahead of time, because we see the potential for it coming.

And that in your example, perhaps if they saw it coming and had put into the contract certain requirements, certain specifications, then perhaps that could confine the litigation to the terms of that contract, and perhaps you wouldn't need to have an extraordinary tort actions or extreme punitive damage claims and the like.

Mr. TURNER. Mr. Nations, is there any reason to differentiate between the Y2K bug and a bug that causes my software not to be able to read zipcodes that began with 7?

Mr. NATIONS. No, not actually. Could I, Representative Turner, address the trillion dollar question?

Mr. TURNER. Sure. Certainly.

Mr. NATIONS. The etiology of the trillion dollar estimate was this joint committee on March 20th, 1997, when Managing Director Ann Coffou of—it's not the Gartner Group, it is the Giga Group, testified. It is the Giga Information Group, testified before this committee that the amount the legal—amount of litigation associated with year 2000 is estimated to be \$2 to \$3 per dollar spent on repair.

Well, first of all, we have no earthly idea what the dollars spent in repair will be. To say \$2 to \$3, you have got a substantial difference there when you are talking in terms of billions. So this is a sheer guesstimate.

What happened was that her testimony here was reported at a Lloyds of London conference in London. It was picked up by the press as being a Lloyds of London estimate, and has been carried forward then from that time forward. It is now gospel that Lloyds of London says that this is going to cost \$1 trillion. The fact of the matter was, it is a very small guesstimate based upon every assumption of which is subject to huge variance. It is a ridiculous number, is the bottom line.

Mr. TURNER. Well, you know, I am certainly one who—I am skeptical about that number. I guess even beyond that, the thing that is troublesome to me is when you take the words Y2K out of this discussion and you talk about the hypothetical I shared of not being able to read zipcodes that began in 7, what I am looking for is in that circumstance, why would we change contractual rights under our current legal system to protect the manufacturer or the producer of that particular computer bug. If there is a reason to do it, it would probably also apply to the Y2K bug.

But short of that, I am not sure exactly what we are doing here, other than protecting a lot of folks that from my perspective I don't represent. The criticism that seems to be being discussed here today are the kinds of criticisms that we can hear directed toward the legal system generally in any kind of litigation.

So I am looking for the specificity of the Y2K problem and why this remedy is important because of Y2K. Because I know there are going to be winners, there are going to be losers if we change the law. I personally think I may be representing the losers.

Mr. NATIONS. The direct answer to your question is that that situation with the 7 zipcode, would be handled under existing law under the UCC as either a breach of contract or a breach of an implied warranty for ordinary use. There is no need for any further legislation to solve that problem, just as there is no need for any other further legislation to solve the Y2K problem.

Mr. TURNER. Mr. Donohue, I want to ask you to comment.

Mr. DONOHUE. Yes. Two comments very quickly. The Giga Group, as was mentioned, was involved in that. The Gartner Group also did a survey and a study, and said it would be \$858 billion. The American Bar Association at their convention had a series of polls and surveys, and came out with some numbers near a trillion dollars.

I don't think any of these numbers are finite. But just my feeling in talking to business people all over the country and listening to the discussions of legal groups and others, that this is going to be a very big number. I will yield to you that maybe it's not a trillion dollars, maybe it's \$1.5 trillion, maybe it's \$500 billion. It is a lot of money.

The second thing is, and I would just make this point. I think there is a little difference between the 7 in the zipcode issue and what we are talking about on the Y2K problem. Y2K is a universally integrated system of technology that brings everybody into the game. You are in the game if you have a small company in

your district who is tied into as a distributor to a national company. Your small company may be the person that screws up the whole deal, if in fact something in their system is not picked up ahead of time and affects everybody else's system.

We are not sure really what is going to happen here. I would just turn for one second to the tremendous challenge that you have in dealing with our own Federal Government system. If you are not comfortable that the greatest government in the world, with more money than anyone else has to deal with this problem isn't going to screw up a whole lot of things that deal with your constituents in your district, I don't think that simply looking at Social Security is going to say Social Security is protected, how is that integrated with the IRS? How is that integrated with Health and Human Services? I think we have a national issue here we ought to look at one time differently.

It should not apply going forward to all the other tort reform discussions. This is a one-time deal around one date and around one set of technology challenges. I think it can be looked at differently.

Mr. TURNER. Mrs. Morella, is my time up?

Chairwoman MORELLA. It is, unless you need another minute, because we will have another round too.

Mr. TURNER. I was just going to ask Ms. Lundberg if she would comment on the same issue.

Ms. LUNDBERG. Mr. Donohue addressed a lot of what I was going say. The point I was just going to make was that it is not just an issue with technology vendors and providers. It is an issue, as he said, of company to company. The companies who have bought the products, changed the products, developed their own software, and it's a very inter-connected food chain, that it is not just a matter of going out and buying a technology product that might have a bug in it. It's more of a business-to-business issue as well. That was the only point I was going to make.

Mr. EFFROSS. If I could just add, Congressman Turner. I think one of the issues also that underscores what a number of my colleagues on the panel have been saying, is both in contract and in tort, there is a question of reliance. Did these people rely on, whether they owned software or not, other people's treating them correctly or that the software that they were using or that other people, was going to work here?

I think there is also underlying a number of the comments pro and con regarding this bill is a question of reliance on law. Is there in fact a reliance that has been built up in a number of these contracting parties on what the law already is? Should it not be asked, are we somehow changing the rules of the game now in destroying what reliance they had in the predictability of the system? Particularly when it is not quite clear to what degree there will be a technological problem or a legal problem. I happen to think there will be both, but one is clearly dependent on the other, and there are no clear parameters for deciding really either, until it happens.

Chairwoman MORELLA. Thank you, Mr. Turner. I am going to turn to Ms. Rivers. But I do think, Mr. Turner, you have a little bit of a Polyanna-ish attitude with regard to the fact that there won't be problems or costs involved with lack of compliance, maybe

inadvertently with Y2K and the litigation, but that is what this hearing is about. Thank you.

Ms. Rivers.

Ms. RIVERS. Thank you, Madam Chair. I have a lot of questions about the whole system as it exists, and why we should make changes in particular.

But before I do that, since we have been talking about some sort of compilation of expenditures, what we actually are going to have to pay for Y2K, I am interested in knowing now just how much litigation will cost, but I wonder particularly to the Chamber of Commerce, if you have looked at what the cost to American business will be if every business affected truly has to wait 90 days for remediation. In other words, every restaurant has to close for 90 days. Every drycleaner has to close for 90 days, every grocery store has to close for 90 days, every doctor's office has to close for 90 days. What is the cumulative cost of those kinds of impacts on the United States?

Mr. DONOHUE. Well there is a cost tree coming up the tree before we get to the year 2000. This, Congressman Turner, are numbers I can quantify. We will spend close to \$1 trillion in the American business community, and by the way that includes hospitals, and universities, and all, going out to try and make sure we are Y2K compliant. In a great entrepreneurial society, a lot of people have made good business out of that.

The question of what the costs are following the year 2000 or moving into it, as people try and use credit cards to buy things that have payments in the year 2000, those costs come in three areas. One is in the continued cost of fixing whatever it is that is not working right. Second, is in the cost of lost productivity, while people have gone off to fix that and are not doing their actual business. The third is the cost of any incremental litigation, either for actual losses or punitive damages.

Now when you put all those numbers together, considering that to get where we are on 2000, we have spent close to \$1 trillion, you have a lot more of that going forward. This is not all about litigation. I mean we are going to spend a lot of money on this no matter what.

Ms. RIVERS. Right. But I think it is important when we talk about justification for the litigation, because we are talking about a considerable financial impact. I think it is important for us to also understand what the financial impact of this particular piece of legislation, and leaving a fairly long window for remediation.

Mr. DONOHUE. Well, I think you raise a very good point about the issue of how long people have to wait to sue. By the way, I have read and heard, and I was on the panel when the gentleman I think from Texas talked about his cash registers and everything that didn't work. I don't know who that company was, but they are going to pay—you know, they are going to be very well sued. That is the sort of a horror story that I wondered why it took so long to fix.

But I believe here what we are saying is if everybody rushes to the courthouse the first time there is a problem here, there's not going to be any room in the courthouse. What we are saying is, can you take some small period of time, call you up. I run this res-

taurant you are talking about. I keep putting my credit cards in here for approval, and American Express keeps going tilt and it doesn't work. Well, are we going to file 700,000 lawsuits the next day? Or are we going to give American Express some time to fix the access to their approval computer?

There is no perfect system. But we just think there ought to be a small pause getting to the courthouse. Is 90 days right? I don't know.

Ms. RIVERS. So the answer to my question is is that we really don't know what the cost would be to balance as we look at the bill?

Mr. DONOHUE. That's right. I know more what the cost is going to be one way or another we are going to spend hundreds of billions of dollars.

Ms. RIVERS. I have a question about the existing standards of liability. Essentially my concern is that in some ways this is a back door into tort reform in general because it looks to me as if the Y2K issue becomes sort of an extraordinary vehicle to deal with issues that are currently recognizable as legal claims in our system. I mean we know how to deal with contract issues. We have general standards for liability. And we have juries who make determinations about punitive damages within standards that already exist.

My question is, much as Mr. Turner's was, is there anything in particular about Y2K that now makes it impossible for us to rely on existing legal standards, makes it now impossible to rely on the efficacy of a jury system? Is there something about this situation that is extraordinary? Or are we just taking the first step to the same tort reforms that many organizations have been advocating for many years?

I'll start over here on that end. I would like to hear from all of the folks.

Mr. ANDREWS. I am not sure that there is anything so extraordinary about this in terms of the types of issues. I think it is the volume that most of us are concerned about, notwithstanding Congressman Turner's question about what that volume is. I think that this is a legitimate issue. As I said earlier, one concern I do have is that I don't think, for instance, this is something that is appropriate or that there is a public interest or benefit in having punitive damages associated with this. I think people are making a good faith genuine effort to fix it, whether they can do so in time, whether they will be able to do so completely, whether they will be able to deal with inter-operability, I don't know.

Ms. RIVERS. Do you feel that juries could not address the issue appropriately relative to punitive damages in Y2K?

Mr. ANDREWS. I think that they quite probably could, but I think that if we are trying to do something with this extraordinary problem, that is something that we might want to consider.

Mr. NATIONS. I think the law as it exists today, the business rules that have been relied upon in addressing Y2K so far by the businesses that have already spent literally hundreds of billions of dollars, are perfectly adequate for handling Y2K litigation that will follow this. Because there are not only rules here concerning breach of warranties and breach of contract, and duties of due care

and the business judgement rule that the businesses have to follow, but there are also remedies here for those people who have followed the business judgement rule.

If you look at two corporations, one follows the business judgement rule, they meet their duty of due care, they remediate, they do all those things they are supposed to do. Then they are out of business anyway, or shut down anyway because their vendor did not do so. Now they look to the UCC, they look to the current law for remedies, and they want that breach of warranty action or they want that breach of contract action, and they should have it.

The UCC has been handling our business litigation for 25 to 30 years in the various states. This is exactly the type of thing that our business law is designed to handle. It can handle it fine.

Ms. RIVERS. Thank you. Ms. Lundberg.

Ms. LUNDBERG. Yes. I agree with Mr. Andrews that inherently there is nothing about the issues that is different. It is the volume. It's just the enormity of the problem. As others have said here today, I believe that potentially there could be a significant hit to the economy from the failures themselves. Forget about the liability and the litigation and the costs in the courts. So I think that is where the concern comes in.

Ms. RIVERS. But the hit to the economy would exist irrespective of how the damages are handled after the fact?

Ms. LUNDBERG. Absolutely. Absolutely.

Ms. RIVERS. Professor Effross.

Mr. EFFROSS. Congresswoman, I would say that as we stand now legally, at least in my estimation, we are very well equipped to deal with the legal issues arising out of Y2K. That is going to raise a certain number of factual issues, particularly fact-sensitive issues with regard to each particular case.

But I don't see that we need to establish a whole new brand or breed of law, or a whole new type of court. In fact, what I would suggest is rather than perhaps establishing some specialized Y2K court like we now have bankruptcy courts, if it came to it, if a number of cases were that similar, possibly to consider something like the multi-district litigation that is now in the federal system. But the volume is the issue. I am not so sure that we need to create a new body of law or new courts, or to say this is beyond the scope of ordinary jurors. I think they are reasonably equipped to handle it.

Ms. RIVERS. Okay. Mr. Donohue.

Mr. DONOHUE. Yes, Congresswoman, let me just mention one thing. My colleagues reminded me on the question we engaged on before. It is 30 days before you can go to the court. Then it is up to the judge if the other party is being helpful in fixing the problem, to grant the other 60 days. Otherwise, you are only talking about 30 days.

Ms. RIVERS. Is there a standard for helpful?

Mr. DONOHUE. The judge sets the standard as in most courts for those kind of judgments.

I would just say about your major question, I think it is a very good—what makes this different. I think it's everybody is in the same boat at a very, very challenging time. It is choppy water. We

ought to look for a way not to upset a very fine balance in our economy. I think that needs your special consideration.

Ms. RIVERS. Thank you.

Thank you, Madam Chair.

Chairwoman MORELLA. Thank you, Ms. Rivers.

It's now a pleasure to call on Ms. Jackson Lee, for any questioning.

Ms. JACKSON LEE. Again, Chairwoman Morella, let me thank you for your kindness, and also the wisdom of this hearing, and the continuity and persistence of you and Chairman Horn, and our Ranking Members for continuing the oversight responsibilities that we have.

Let me just take a moment of personal privilege and say that I started out earlier today, and the times otherwise, since I expect to hold a Y2K informational forum in Houston because of the many inquiries that I have gotten, and the enormous interest that I have in this area, that one of the things that I would like to see being the theme of our oversight hearings is the fact that the Government is concerned. It realizes the challenge ahead of us.

Mr. Donohue, you have given us a challenge. In fact, I agree with you that we need to recognize the broadness of it, and particularly with our business community. We all have business constituents.

My focus, of course, is that we send out reasonable signals of even-handed information and to stifle as much of the hysteria. This is not to suggest any discussion here is such. I am just noting to you that we need to work together to provide real information.

Madam Chairperson, I wanted to take this moment of personal privilege to acknowledge the Texas broadcasters. I have met with them. Of course, it could be the Maryland broadcasters. But these who have acknowledged their interest in getting PSAs and other types of information, that they would be willing to share, not on how to sue, litigate, but certainly on issues dealing with Y2K. I just thought that I would bring that to our attention, because I hope the tone of this hearing will be more on how we can be problem solvers on this very important issue.

With that, let me go to Mr. Andrews. Help me walk through. One of the points and the themes that we have been hearing is the enormity of the problem and the fact that we are talking about large numbers of people which really characterize this fear of litigation. You have indicated that you counsel businesses. It is my understanding that in doing so, the very point that I believe has been made in terms of the need of litigation really happens anyway. Which is, I don't believe that businesses from business-to-business or however, including consumers, run to the courthouse. They really try to work out their situation.

You have talked to me about breach of contract and implied warranty. Would you lead me through, for example, in advising your clients on this issue or as we may look to problems, wouldn't there be a moment anyhow where the client, because they really want to get on their business, I don't think they are looking to spend any extra time in courthouses. Isn't there a point when there are negotiations over problems and concerns in order to try and work them out, under these particular provisions that you have already mentioned?

Mr. ANDREWS. I think that you raise a very good point. That is exactly what we do try to counsel our clients. Our clients don't want to be in litigation. It is costly. It is time consuming. It is distracting from the regular business. What we are primarily trying to do is to come up with ways that they can avoid litigation.

Now one of the things that is somewhat unique about the year 2000 problem is that you don't know for most companies and entities whether they are going to be a plaintiff or a defendant in any litigation. So what we are trying to counsel them on is how to structure it, how to set things up in terms of contract negotiations, in terms of warranties and disclaimers, and contract review and legal avoidance, and liability avoidance. How to set it up so that you won't be either, so that you won't be a defendant because you haven't created any liability for yourself. You haven't made any great claims or warranties that you can't live with or meet up with, and that you also have got a contract negotiation with your third parties with whom you deal, that you have got assurances and certifications from those parties, what have you, so that you are not likely to have to sue them because they are going to comply with what you need. They are going to work that out by negotiation hopefully now so that you won't have to incur the cost and disruption later.

Ms. JACKSON LEE. I appreciate very much that analysis, because I think it is important to note that we won't throw to the wind our normal negotiating processes. You are going to refine them, as I hear you saying, in terms of giving guidance to clients, business clients, about how you pre-suppose, if you will, circumstances that might bring them in the courthouse, but let's find out how otherwise we can negotiate around already standard legal processes.

I would like us again, without coming to any conclusion about what we should do, and I have already made my leanings known, but I think we should remain open. I think it is important to note that there are present structures that might be able to be utilized, but that we should keenly be aware of monitoring what may ultimately happen.

With that, let me ask Mr. Nations. One of the added points of this hearing is that I am a member of the Judiciary Committee, and the liability legislation will make its way through there. I think it is important, if you would, define for us punitive damages, because it is not an automatic. You don't walk into the courthouse, make allegations, and immediately have standing for punitive damages. I know it may sound elementary, but I think it is important to distinguish the fact that we are talking about egregious incidents that might even be—you might consider, the court or the jury might consider punitive damages. Would you just share that with me, and the likelihood of such?

Mr. NATIONS. I would be glad to, Representative. I am glad you raised the issue because we hear in each of these hearings all this talk about outrageous, billions of dollars in punitive damages. Punitive damages is extremely, extremely difficult to recover. I have been practicing law 33 years. I have had exactly 1 punitive damage recovery in that 33 years. It was appealed all the way to the U.S. Supreme Court. It is just not something that happens in the absence of egregious conduct.

The definition of gross negligence is a wanton, wilful, disregard of the rights of others. In most cases, you don't even think about pursuing punitive damages because punitive damages is not a possibility. In contract cases, in breach of warranty cases, it is extraordinarily—you have no provision for punitive damages under the UCC. You have no provision.

Where you get punitive damages in this type of situation would be in fraud cases. You have to have a tort element to get to punitive damages. It will take just a minute, but I would be glad to give you an example, if you—

Ms. JACKSON LEE. I will indulge you for a minute. I have a question for Mr. Donohue, but go ahead.

Mr. NATIONS. If I may.

Ms. JACKSON LEE. I'll just indulge you for a minute if my time doesn't run out.

Mr. NATIONS. If we look at the case of Courtney v. Medical Manager, which is one of the 56 lawsuits that has been filed. As a matter of fact, it is seven of the 56 lawsuits that have been filed to date. It is a class action case.

Dr. Courtney is a small-town OB/GYN. He spent \$13,000 for a Medical Manager software package that would run his practice for him. It worked fine. It lasted for 12 years. It worked fine until 1997. In 1997, he bought a new package. They came to him and said, "This is the latest thing. It will do everything but deliver the babies for you. It will last you for a good 15 years." He spends \$15,000 for it.

Almost a year to the day later, now this is a small-town practitioner, almost a year to the day later, Dr. Courtney gets a letter from Medical Manager Incorporated saying "We forgot to mention to you that the package we sold you last year for \$15,000 is not Y2K compliant, and in order for you to be up and running by January 1, 1999, you have to have a new package which costs \$25,000."

Dr. Courtney went to one of those lawyers that we heard so much about. That particular lawyer happened to know what he was doing. He brought a class action. It turned out that there were 17,000 people, 17,000 doctors, small-town practitioners who were similarly situated. They were all being hit for \$25,000 each by Medical Manager. That's \$435 million that Medical Manager was trying to get from—by selling a Y2K upgrade.

What happened after the lawsuit? And incidently, they tried for two months to settle the case before suit was filed. They got nowhere. They filed suit. Within two months after suit was filed, they reached a settlement. And guess what the settlement was? It turns out that when confronted with a class action with 17,000 mad small businessmen, Medical Manager came up with a patch, a magical patch that all you have to do is insert it into your old system, and all of a sudden you are Y2K compliant.

Now that is the type of fraud—that is a type of fraud, that is a type of profiteering which a jury may get mad about and may consider punitive damages. However, it is important to note that in that case, there was—it was settled. It was settled for the 17,000 doctors getting their patches, getting their systems up and running. Then they went on down the road. They didn't even pursue

punitive damages in that case. But that is the type of fraud you need in order to talk about punitive damages.

Ms. JACKSON LEE. They just wanted to get back to work, and they used the normal litigation structure that exists today.

Mr. NATIONS. Exactly.

Ms. JACKSON LEE. Let me ask Mr. Donohue quickly, and I know—what I am concerned about, you have been very passionate, and these are important issues to all of us. But I am concerned, and you have noted the work we have to do in the Government. I am admonished. We know that. What kind of private sector efforts are going on separate and apart from the seemingly support for liability limitation, but what are we seeing the private sector do to enhance their Y2K capacity? Are they being deterred by looking to litigation limitation from doing what they really have to do to get their businesses compliant?

Mr. DONOHUE. Well, first of all, Congresswoman, we have been—the business community, which you know, what does that really mean? But businesses all over the country have been investing major amounts of money really over the last three years, some went back before that, to change systems, to upgrade them, to test them. For example, the Air Transport Association which represents the airlines, is just spending \$15 million to test the changes that they have already made in their systems to make sure they work.

There was an excellent piece on television this weekend how a lot of the bond traders and stock traders worked all weekend on the first of a number of things they are doing. Now these things cost lots and lots of money. They have been hiring experts. They have been testing systems. They have been looking for glitches. They are investing significantly in this issue.

We at the Chamber have been working very, very hard to alert small companies and large as to programs that are going on, people they can contact, activities they have to undertake, and fixes they probably have to handle. In fact, if I can be very personal, I sort of wish I could go sue the guys that we bought 23 years ago, whatever it was, that we bought our system from that we are trying to fix. We signed \$100 million 10-year contract to upgrade the Chamber's system, which is, you want to talk about nightmares, we can have a little nightmare conversation.

But I think the final thing I want to say, there are some fundamental realities that we need to look at. We don't have to be so naive that we don't understand that certain groups of the trial bar have spent a good amount of money to research how to file these lawsuits. I mean I have not been there while they have done it, but I have heard it from their own parties. I have heard their reports and their discussions amongst themselves. They are looking for the best way to do this.

We need to be as diligent and figure out, A, how to avoid lawsuits by doing smart things. And two, how to say in this one instance—I am not talking about tort reform, that's another battle we'll have on another day. How do we recognize that everybody from our own Government, to every company in this country could somehow be affected?

I will give you one thought. In your office, in my office, in every office around this country, we have bright, young computer pro-

grammers that have been there for years and they are getting better every day. They are not satisfied with any system. They are always fixing it a little bit. You know what? That is where we are going to be in trouble. We are going to be in trouble in every Government agency where somebody sort of fixed it. We just don't have that in the documentation.

This is a very hairy issue. I just think we ought to take all of our convictions about tort reform, about the rule of law, about everything we are working on, and for one minute hold them very strongly but look at this issue and say should we deal with this one time for a limited period of time and then it goes away, to just keep some order in a very scary situation?

Ms. JACKSON LEE. Even as you speak, however, this issue of lawsuit liability is not impeding businesses as you represent to me from looking at this?

Mr. DONOHUE. I do believe, as was pointed out by Mr. Davis and others, and by some of the people on the panel, I believe that it is very, very clear that lawyers are telling people from a legal point of view, don't say anything, don't do anything, don't expose yourself to liability. I think that is good law, good general counseling. I think it's lousy business. I think we need to get out and be very open, and risk, risk our own legal position to work with our customers and our suppliers to do everything we can to fix this. That is what I am encouraging.

Ms. JACKSON LEE. The Chairwoman has been very indulgent. I will thank her for that. If I may just leave one question on the table, as I think a very good point was made about remediation. As I said, I would like us to be problem solvers, and so I would like people not to be, if you will, held up on the issue that we don't have solutions. I would like us to be open-minded to the issue of remediating as opposed to putting people in the posture of legal lawsuits at this juncture.

Chairwoman MORELLA. I think that is critically important. Of course that is what we have all been working toward, is we have got to remediate and we have got to correct the problem to be compliant.

I wanted to also mention that most of us have had forums in our districts. I commend you for doing that. Where we have pulled in the Chamber of Commerce, the business community, organizations, as well as state and local government, and the Federal Government, and vendors as a matter of fact in that. I have been pushing the private sector, and many of them have been doing a great job of coming up with little flyers explaining, you know, "We're Y2K OK" and explaining to consumers what to expect, what has been done. I just got one the other day from the Red Cross, for instance. I think we all have a responsibility to do that, use PSAs and whatever.

I want to ask you a little bit about insurance, and then I have one other issue. I do want to also comment that Republicans have a conference right now which is why you may be getting some questions sent to you.

For purposes of business interruption insurance, it is likely that many insurance carriers will take the position that the year 2000 problem is not a fortuitous event designed to be covered under

their policy, and that business interruption losses incurred because of the Y2K problem therefore would not be covered under existing business interruption policies. I am just wondering if you know whether or not all insurance companies are now adopting this position? I think this gap, as I understand it, means that some insurers are offering their own Y2K coverage. I just wondered if you would like to elaborate on that.

We can start anywhere at all. Mr. Nations, if you would like to comment on it first?

Mr. NATIONS. The insurance industry across the board is making it very clear that they have no coverage on Y2K. They are right now in 1999, as policies are up for renewal, they are including specific Y2K exclusions in policies for businesses when they come up for renewal. They are claiming under comprehensive general liability, which is an all-risk policy, that the all-risk will not be construed to include Y2K because Y2K is an expected event, as opposed to a fortuitous event. It is an expected event. "Expected" is the magic word that is in the exclusion under a comprehensive general liability policy.

The only place I have heard where the insurance companies have indicated that there may be coverage, simply because they don't have any way to get around it, is on directors and officers liability coverage, corporate officers malpractice, if you will, which is them acting in a negligent manner. The way they would circumvent that would be that it was willful, that it was a willful act, it was not corporate directors' negligence, it was a willful act. Therefore, willful acts are not covered.

So that brings us back to if lawyers are out there telling their corporate officers, "Don't take any action on Y2K right now," the best lawsuit they may have would be a legal malpractice against their own lawyers.

Chairwoman MORELLA. Would anyone else like to comment? I think it is a frightful concern.

Mr. ANDREWS. I think, Congresswoman Morella, that it is a much more complex issue than Mr. Nations suggests. I think that at least insurance companies with which I work, have all said appropriately that the termination of whether there is coverage given a particular claim would depend on the facts of that specific claim and the specific terms and conditions of the insurance contract at issue.

For instance, Mr. Nations touched upon several different types of insurance contracts, and there are quite a number. It is going to make a big difference who is making a claim against whatever party, what is being alleged, and what the terms of the contracts are. I will say that I do not believe, based on my research, that a premium was ever charged or collected for a year 2000 exposure. In fact, the insurance regulators are finding that very reason to be the basis for approving year 2000 exclusions, because they are saying look, this was an anticipated coverage, there was not a premium charged for it, so it might be something that should not be covered, depending again upon the facts of the claim and the specific terms and conditions of the policy.

Mr. EFFROSS. If I may add, Congresswoman Morella.

Chairwoman MORELLA. Dr. Effross.

Mr. EFFROSS. When you mentioned how, Mr. Andrews, of how this depends on the facts and circumstances of the cases, I recall several years ago one of the moments I was most proud, really proud of being a lawyer, and there have been many, but this was one of them, was when I read a New York Times article about insurance companies refusing to pay for treatment that they deemed experimental. Someone who had formerly worked with the insurance company but now was no longer with them, was asked, "Well, how do you make those decisions?" This person said to the New York Times, "Part of it is we look to see whether this person, the plaintiff, would be sympathetic if he or she went to the press, whether or not that person has a good aggressive lawyer, and whether that lawyer is ready to sue. We take all that into account."

I think a number of the things we have been hearing here today; negotiation is fine as long as the parties know what the legal backdrop is, if the negotiation fails, what landscape they will be plummeting into and what the contours of that landscape are.

I think in fact some people deserve to be sued. Kind of like the police. I mean there are abuses with the police, as with any authority, but the police keep people in line. To some degree, the threat of lawsuits is keeping a lot of companies in line. Maybe they are not doing the right thing, but they are at least worried about it.

Chairwoman MORELLA. Dr. Donohue.

Mr. DONOHUE. Some people deserve to be sued, I agree. This bill allows them to still be sued right away.

Chairwoman MORELLA. It is a concern to me that if there is no insurance available and if you were to get special Y2K insurance, then it means other insurers would be exempted from having it be considered a fortuitous event, as some might, and as you mentioned, Mr. Nations, many of them don't.

I would think that if there were insurance, that one would have to point out to the insurer, prospective insurer, that everything has been taken care of. I don't know, it just seems to me it is a deterrent to corporations and entities to be involved in information sharing beyond the legislation that became law if in fact they don't feel that they have something that they can fall back on for good faith efforts.

Does anybody want to comment on that? Is that something one shouldn't worry about, the whole concept of insurance and business interruption insurance?

Mr. ANDREWS. I think again, an insurance policy is just a contract. That contract in the year 2000 context has to be determined by court applying the language of the contract. I am very afraid of hearing people say well gee, the insurance carriers have deep pockets and this is a big problem, and maybe they can pick up some of the pieces, just like some courts who are outcome-determinative and outcome-minded saw in the environmental area. There they have sort of changed the terms and the meaning of the contracts. I don't think that we should do that here. If the contract terms provide for coverage, given the facts of the claim, then there should be coverage. If they don't, then we shouldn't try to change that either through the courts or through the Congress.

I also I guess would suggest to Professor Effross that I wouldn't necessarily agree or believe everything I hear or read in the New York Times.

Mr. DONOHUE. Madam Chairman, the one point you just made though I think is worth repeating. There is great caution in small and large companies about going sort of public with their concerns, with their customers, with their suppliers, and with their bankers and everybody else if in fact what you are doing is creating a record for liability, and for expensive liability, as opposed to covering actual damages.

I respect the point made by my fellow panelists here about maintaining a common system of law, and the fact that there aren't a lot of punitive damage suits. Although I would say if you were to draw a curve, that the number and the amount of money is going up dramatically, if we could infer anything from that.

Chairwoman MORELLA. Probably so.

I would like to just comment on the third party bit. Let's say my company or my organization is compliant, but I have to interface with another organization or entity that is not compliant, it infects my system. Then maybe that infection could be spread to another party with which I engage. Who is liable? Or what do we do about a problem like that? Is there a word like litigatable?

Mr. EFFROSS. I think you would be falling back to some degree on general concepts of negligence. Are you negligent in dealing with a party whom you are not satisfied is compliant? Are you negligent in not examining your own systems after that contact has been made and before the data goes to the other party you are dealing with? As well as what are the contracts you have with those parties? Do they require you to take any particular efforts with regard to this? Is there some kind of industry—even if they don't, is there some kind of industry standard for what people are doing to diagnose their own systems periodically?

Chairwoman MORELLA. Mr. Nations, do you want to comment on that?

Mr. NATIONS. I would defend that case in a heartbeat before a jury. I have known a lot of highly intelligent lawyers in my life. I have never met a lawyer or a group of lawyers who had the collective wisdom of 12 citizens off the street that we call the American jury.

In a situation like that, you have—we have the American jury system at the bottom line of all this weeding this out for us. If a claim like that got to the point of being submitted to a jury, and you have done everything you can possibly do, and you are being victimized by someone else, then you are not going to be liable in that circumstance.

If I may address one thing. Where there is going to be a problem, and that is on the joint and several liability. If you carry your analogy on out, that the party that caused it initially was a foreign vendor, say, and this is a real problem and this is the problem with respect to joint and several liability or making several liability or petitioning liability. That is, that if you partition liability and the foreign vendor is the party that is at fault, many of these products, most of these products are sold by foreign vendors, FOB Yokohama, FOB Taipei, wherever, those people are not—those companies are

not doing business in the United States. They are not subject to our jurisdiction.

To put the end user, a small business, in the position of having to sue a vendor in Taipei who is the actual cause of the problem, is just to say that is not going to happen. That that lawsuit will never occur. The reason you keep joint and several liability is the end user goes back against the seller, who goes back up the chain of distribution. The ultimate person in the United States has a contract with the vendor in Taipei, that they can sue on that contract, and it should provide jurisdiction in the United States. They are the only ones that have that opportunity. That is why joint and several liability is so important to be maintained, especially in Y2K situations.

Chairwoman MORELLA. I am going to now defer to Mr. Turner for any questioning.

Mr. TURNER. I want to ask one of you who is familiar with the bill to help me with a section that was referred to earlier, this section 305, which limits the recovery of economic losses. As I understand it, if you make a tort claim, you may recover economic losses only, as it says, upon establishing that any one of the following circumstances exists. One of which is that there was contract providing that you recover economic losses. The other was that it is a personal injury. Third, that there was some damage to tangible property.

So in essence, any economic loss, I assume a business loss, would not be recoverable unless there was a contract saying you could recover it. I am curious, and maybe Mr. Nations is right. I wanted to ask what kind of tort claim could be made that you would be barred from recovering your economic loss under this section?

Mr. NATIONS. I don't know of any type of tort claim that could be. If you lose your rights under this section, I don't know of any tort claim that could be brought that would remedy your situation.

You get into the situation where you have the losses such as Mr. Yarsike had in the Produce Palace International, where he lost—he had huge business losses. He lost his customer base. He was shut down for 90 days. When he opened a brand new store, he was shut down, out of business for the first 90 days after his grand opening. If you are confined to what you actually—to recovering what you actually paid for the computers that didn't work, then that is going to be an egregious loss for Mr. Yarsike and for his Produce Palace International.

So we have to look very carefully. There is no need in that kind of situation for punitive damages or anything else. But he needs to be able to address the actual losses that he has had. You need not confine the actual losses that he suffered in his business in that situation, which he said were around \$300,000.

Mr. TURNER. So you are saying that if this became the law, this section 305, that he would not be able to recover those business losses?

Mr. NATIONS. I have not studied section 305 in that context, because we were not addressing this specific bill today. But unless he is allowed to recover all of his losses other than—all of his actual losses other than just the cost of the benefit of the bargain, the cost

of what he paid, getting back what he paid for the computers that didn't work, he would have a substantial loss, yes.

Mr. TURNER. I think I am reading this correctly. It says if you make a tort claim, you may recover economic losses only upon establishing that any one of the following exists. That is, you had a contract.

Mr. DONOHUE. And he had a contract. He had a contract.

Mr. TURNER. But if his contract didn't say that he could recover his economic losses, which I don't know if it did or didn't. I mean in a lot of cases I could see you buying some software to run your grocery store cash registers, only you don't have anything.

Mr. DONOHUE. But he did have a contract, and under current law. The other thing, there was a fourth issue I think. Congressman, you might help me. I believe there was a fourth issue that said as otherwise covered by current law. So they would still be able to move forward on a host of other conditions.

I may be wrong. I just asked my colleague. I think there are four points there, and you mentioned three of them. I think there is a fourth one. Is there?

Mr. TURNER. I only see three. One is the losses must be provided for in the contract. Another if it involves a personal injury. Third is if it involves damage to tangible property.

Mr. DONOHUE. I thought, and we can all check that, I thought—yes. If you look on page 23, line 9, it said "economic losses shall be recoverable in a year 2000 action only if an applicable federal law or applicable state law embodied in the statute or controlling judicial precedent" et cetera, et cetera, and I believe, and by the way I am not a lawyer, which gives me a great advantage here, I believe that means that a lot of the prevailing statutes are at hand, and we could discuss that in terms of when the bill is brought up. But that is my understanding. I just ran out of everything I know about that.

Mr. TURNER. I probably ran out ahead of you.

Mr. EFFROSS. As I understand it, Congressman, you still would be able, whether or not the contract specifically said so, to recover or at least try to recover economic losses under a contract law claim.

Mr. DONOHUE. I think that's right.

Mr. EFFROSS. So I am not quite sure what you are losing here by limiting the economic damages you can go under for a tort claim unless you have such things as a very well drafted contract which says no warranties and this and that to explicitly limit any type of contract claim you could have.

Although as I have suggested in my statement, many of those limitations of damages clauses in contract law may themselves be seen as conscionable, and may be stricken by a court. So whatever this says, you may well still have a chance for a home run in contract.

Mr. TURNER. Mr. Nations, can you think of a tort claim that would be severely limited by this particular section that we should be concerned about? It just strikes me as an unusual section to basically say you don't have a recovery for economic damages in tort claims unless one of those three elements are present. I am really

struggling I guess to find out why that section is in the bill. What is it designed to cover?

Mr. NATIONS. I actually, I actually can. The fourth provision about economic losses being recoverable in the year 2000 only if there is federal law is for the purpose of limiting this, to make sure it doesn't create any new causes of action. It is saying that unless federal law and state law already exist, that nothing will be—that this section doesn't add anything. So that is a limiting provision. So it is only the first three provisions that you talked about. So I don't see, I really don't see the applicability of this, frankly.

Mr. TURNER. There's no section that caught my attention. I am not sure I know what it is designed to do here. It is pretty straight forward. It limits the personal liability of any officer or director, a corporation or business, to \$100,000 or 1 year of their salary. Why was that important in this legislation? Why would you particularly single out the corporate officers and protect them to that extent?

Mr. EFFROSS. Because I think there are significant fears, Congressman Turner, that a number of these people have been in essence, asleep at the switch. Now they are going to be waking up and shareholders are going to be suing right and left.

In my materials, there is a reference to the website of Milberg Weiss, which is well-known for launching a number of shareholder suits. On their website, there is even a link to their year 2000 suits, which each of which they describe. They and numerous other firms must be gearing up for this kind of thing because once the share price falls, whatever contract and tort claims the company itself may have, the shareholders will say, "You people should have been awake and aware of what was going on, and we can take after you personally this so-called business judgement rule, which normally protects any decision a director makes as long as it's not heinously stupid or disloyal to the company, is no longer going to protect you because in this case, you were not fulfilling your duty of care. You weren't informed." So someone is trying desperately to look out for the interests of directors and officers.

Mr. DONOHUE. But, Congressman, you need to understand how some of those suits actually work. I am on a number of boards. What the bar would do, the plaintiff's lawyer, once having a client, would sue the directors of the company with the idea of getting at the director's liability insurance. In a big company, it could be hundreds of millions of dollars. They sue on behalf of the company. They sue on behalf of the shareholder. Then the idea is that you are getting the director's liability protection and you are going to give it to the company, but you are going to keep a third of it.

The issue here is to limit that in this instance because it provides an extraordinary way for people that were injured not at all, or in a very marginal way, to file huge lawsuits against all the companies in this country through their directors that have extended amounts of liability protection to cover other kinds of activities.

I think it is an area that bears a little more education in terms of the Committee. What we are trying to say here I think in this legislation, is that that avenue, of shopping a client and then going—then suing on behalf of the shareholder, suing the directors

to get at that insurance which is all there for directors' activities, when in fact there is no insurance for what the company might have done, is a way to get at a lot of money and to collect a lot of legal fees.

I would encourage you, sir, to make yourself familiar of how that has been done of late, and what the impact could be here.

Mr. TURNER. Mr. Nations.

Mr. NATIONS. If I may address that issue. One of the reasons that you should have unlimited liability, no cap on the directors and shareholders actions, is because directors and shareholders are a major part of the problem. As the Senate Committee found, the Senate Special Committee on the Year 2000 found "Leadership at the highest level is lacking. Misconception pervades corporate boardrooms that Y2K is strictly a technical problem that does not warrant executive attention. Y2K competes poorly against the issues such as market share and product development."

So the officers, many officers have—and directors of corporations, have ignored this problem. They have procrastinated. I have heard chief information officers come in and say look, we started asking for money back in 1992 to remediate this problem. We couldn't get it. We'll take it up next year. Well, I need \$10 million to solve the problem. What do I get for it? Well, you will still be in business on January 1, 2000. Well, they procrastinate. They put it off, they put it off.

What has happened is a lot of corporate officers and directors who now in 1998 started addressing the problem and saw that it was getting to late to do anything about it, have taken the money and run. They are resigning, they are retiring, they are taking their profit sharing and they are moving on, and leaving the corporations where they are going to be in a position where the value of the stock is going to drop appreciably, and you will have the shareholders holding the bag.

It would be very wrong on behalf of the shareholders' interest to limit that liability to \$100,000.

Mr. DONOHUE. Mr. Turner, if you are a director of a company and you decide now to retire, or as counsel said, take the money and run, and there is not very much money in being a director any more. In fact, it is getting more and more difficult to get extraordinary and qualified directors to serve because of these problems. You are still liable for the actions that happened under your tenure. You are still covered by those liability policies that do exist in most corporations. So you may take the money and run, but there is nowhere to run. You still would be responsible for your actions.

I think the matter here is to say that this is an extraordinary series of circumstances, and anyone, any director in this country could be accused tomorrow, of even the finest companies and the best directors, of not doing enough. I mean at IBM or at AT&T, where I know they have spent a billion dollars on this subject, should they have spent \$2 billion? Would that have been a sound business judgement? Would that be a reasonable man's adjudication or conduct of his position? I think that is always something that could be argued.

We just think that this is one thing that needs some serious consideration, because it is the way to make this a huge cash cow for

people who can allege whatever they want. I mean should we see the Congress as the board of directors for the Government of the United States? Have you held back money on this? Have you made sound business judgements? Are you all liable for this kind of an activity? I mean I think we need some common sense here. That is what we are asking for.

We are not applying this to another issue, another question. It is not a form of tort reform. It is one issue facing the United States. It's here and it's gone in a few years. Then we go back to ground zero and take that matter up on every other issue. I think that is very important to understand. We are all concerned about this matter. I don't know in 1992 there were too many people very, very smart about this issue.

Mr. EFFROSS. I think the question though is not whether they were very smart, but whether they should have been.

Chairwoman MORELLA. I wanted to point out that really this hearing was not to look specifically at a piece of legislation. Nevertheless, I am certainly delighted to note that each of you has a familiarity with the piece of legislation that will probably be going before Ms. Jackson Lee's committee, although there may be a number of changes to it. But it was to talk about and discuss the impact of litigation on fixing Y2K. But I think it has been a really good discussion.

I am going to give you the last question then, Ms. Jackson Lee.

Ms. JACKSON LEE. I thank you, Madam Chairperson. I just want to make a statement on some of the free-flowing discussion. You are right. Though I think this Committee has certainly taken the leadership role in this, and this is an important discussion, I do want to note that just on the idea of corporate lawsuits, there is a business judgement rule. So again, I think existing law will find itself reasonably applied, that corporate directors are not open to liability recklessly because it will be a question of whether they used prudent business judgement. I just couldn't help but get that in.

The other thing that I want to say, and here I am going into the legal analysis, but in any event, one of the things that came to mind, and I am going to give Ms. Lundberg the last word and not me, one of the things that came to my legal perspective is how do you determine what kicks in as jurisdiction? You have got a new law, and you get all of a sudden the grocery guy or the physician, and he is inter-related with somebody in Taipei that has a product and it wound up there, what you are saying is that you will have to go to court, whereas you can go under implied warranty, you can go under breach of contract. You have got joint and several liability. Or you have got to go in say "I think I am under the Y2K situation." I mean you have got sort of the problem of having to put your hat on about am I over here under Y2K? Do I get a better deal under breach of contract?

I really think as our laws have been responsive to technology, you know, you have got various disciplines, but they fall under the umbrella of breach of contract. But it happens to be a case on a medical design feature or something, and somebody else is dealing with another issue. I just have a nightmare about whether I have

got to go in and decide do I want to run over here under the Y2K or do I want to run over here under standard legal action.

Again, we are not in that committee, but Ms. Lundberg, can you tell me in terms of the industry, who we want to help, who we appreciate, are they tuned in and working steadfastly and working with their clients, and I have said the word "remediation." I know that you could be a plaintiff or defendant. You don't know which one you are, so you don't know whether you want remediation because one guide helps, another guide may not.

But is the industry sensitive to these issues, working diligently, working with various clients of theirs, and vice versa? What do we have going on out there now that we should either be aware of or not be aware of, or are not aware of?

Ms. LUNDBERG. As I said in my testimony, I do think that there is a fair amount of reticence because a lot of the question letters that are being sent to companies are asking for guarantees. They are asking, you know, tell me everything is okay. Nobody can say that. Even the companies that have remediated all their systems, they have tested them, they are sound today. They can not guarantee that when January 1 hits, they are not going to have problems.

So what has been suggested by a number of our readers is that, you know, these letters need to change. I think that the Information Sharing Act was a wonderful step in the right direction. But if actually lawyers were to get more involved in drafting these letters that are asking for information so that it was focusing not on are you done, but what are you doing, and where are you at, and took all the legal issues out of it, that that would be a real positive step.

I know that CIOs and companies want to work together to fix this problem. Everybody wants to fix this problem. I think that there are things short of changing law that we can do to help that happen.

Ms. JACKSON LEE. There you go. Thank you for your solution. Thank you.

Chairwoman MORELLA. Thank you, Ms. Jackson Lee. I note that Mr. Horn is here.

Did you want to ask a final question?

Mr. HORN. No. We're fine. The Nation is in good hands. [Laughter.]

We just met on the important things.

Chairwoman MORELLA. You'll have to fill me in then, Mr. Horn.

I want to thank you very much. We have stayed longer than we expected to. You have just been wonderful to come, to give us such excellent testimony. As I mentioned, there will be further questions probably.

Any comments beyond that that you want to offer? Mr. Donohue, Professor Effross, Ms. Lundberg, Mr. Nations, Mr. Andrews thank you all very much. I appreciated it.

The Subcommittees are adjourning.

[Whereupon, at 4:55 p.m., the Subcommittees were adjourned.]



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**NAM LAUDS REPS. MORELLA, HORN FOR
LEADERSHIP ON Y2K LIABILITY REFORM**

Amundson Notes Increase in Advertising by Law Firms Seeking Clients

WASHINGTON, D.C., March 9, 1999 – The National Association of Manufacturers today lauded Reps. Connie Morella (R-MD) and Stephen Horn (R-CA) for holding a joint subcommittee hearing to expand Congress's consideration of the year 2000 liability issue.

"Reps. Morella and Horn clearly understand the importance of the year 2000 liability issue and the potential impact on America's economy," said NAM General Counsel Jan Amundson of a joint hearing of the House Subcommittee on Technology and the Subcommittee on Government Management, Information, and Technology.

"Our membership will be investing billions of dollars in repairing and remediating their systems – an extraordinary effort – for this unique and historically unprecedented problem. Given that manufacturers represent both likely plaintiffs and defendants in Y2K litigation, it's clearly in everyone's best interest to set up a system that allows for fast and fair resolution of disputes," Amundson said.

Noting that countless law firms are already advertising their services for year 2000 related lawsuits, Amundson added: "If we don't do this right, it has the potential to drown the economy in a sea of lawsuits that will ultimately affect everyone in the U.S. and even the world through lost jobs, higher prices, and endless litigation.

"Despite the improved disclosure of information from last year's *Information Readiness and Disclosure Act*, companies are still somewhat gun-shy about letting their cards show, for fear of making themselves targets for costly and time-consuming litigation," Amundson added. "We should be working together to solve the problem, not profit from it."

The National Association of Manufacturers represents 14,000 member companies and affiliates (including 10,000 small and medium firms) that produce about 85 percent of U.S. manufactured goods and employ more than 13 million people.

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NEWS ALERT



**NATIONAL RETAIL FEDERATION**

**STATEMENT OF THE NATIONAL RETAIL FEDERATION
BEFORE A JOINT HEARING OF THE TECHNOLOGY SUBCOMMITTEE
AND THE GOVERNMENT MANAGEMENT AND INFORMATION
TECHNOLOGY SUBCOMMITTEE ON THE IMPACT OF Y2K COMPUTER
PROBLEM LITIGATION**

March 9, 1999

I. Introduction

The **National Retail Federation** is the world's largest retail trade association with membership that includes the leading department, specialty, discount, mass merchandise, Internet, and independent stores, as well as 32 national and 50 state associations. NRF members represent an industry that encompasses more than 1.4 million U.S. retail establishments, employs more than 20 million people, which is about 1 in 5 American workers, and registered 1998 sales of \$2.7 trillion. NRF's international members operate stores in more than 50 nations.

NRF's over-arching objective is to ensure that the U.S. economy continues to progress without disruption caused by any Y2K event. We believe it is in the best interests of this committee to take speedy and reasonable action to ensure that the economy and the well-being of the country are affected as little as possible by the Year 2000 problem.

II. History

In February 1997, the National Retail Federation was asked by our members to begin work on the Year 2000 problem. We took that challenge seriously, and have devoted considerable time, staff and resources to addressing the issue. In June of 1997, our Survival 2000 Project was borne from that mandate and that group has met every four to six weeks since. This group is comprised of retail industry information technology specialists, internal auditors, attorneys and logisticians, and currently has 120 members.

To date NRF's Survival 2000 Project has addressed efforts of common interest in an attempt to provide coordination, efficiency and facilitation. The NRF group published a set of Best Practices in 1998 and is in the process of publishing a guideline for Contingency Planning for the retail industry.

The World's Largest Retail Trade Association

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From the very first meeting, there was general agreement by this group that it was far too late for legislative solutions. They reasoned that so much work had already been accomplished based on the existing legal framework, that new legislation could force a redefinition of the efforts required, could increase the burden and could invalidate past efforts.

III. Where We Stand

Today, in March 1999, most of our larger, domestic members are devoting their time to developing their individual contingency and continuity plans and are engaged in final testing of their internal systems. In most cases our larger members have completed remediation of their computer systems, and have surveyed their business partners. In the third quarter of 1999 most of our larger members intend to freeze their internal computer systems to ensure that no new Year 2000 problems are introduced into their environment.

NRF knows that the retail industry has been diligent in its efforts to address the Year 2000 event, and we're confident that while there may be sporadic inconveniences, we are not likely to see catastrophic failure. During the past two years of effort we have worked under the assumption that the legal framework would remain unchanged. Because of the unique nature of the retail industry, we recognized that our members could find themselves on either side of any legal dispute. For example, as sellers of consumer electronics they might be forced to deal with issues like product liability or they might also find themselves as plaintiffs when dealing with suppliers of goods and services.

It was previously stated that NRF's Survival 2000 Project group has been consistently opposed to legislation regarding the Year 2000 event. However, with a number of states now enacting their own legislation on Y2K, the rules have begun to change. That said, NRF recognizes that there may now be a need for speedy legislation that is fair to all, minimizes the economic impact of litigation, encourages remediation, and provides a consistent set of rules across the country.

Our economy and the retail industry will only remain strong as long as companies are encouraged to correct their Year 2000 problems not by some legislative scheme that establishes incentives for companies to delay action, to avoid remediation or to take their claims to court. NRF would vigorously oppose that kind of rule change.

IV. NRF's Expectations

From the beginning, NRF's objective has been to facilitate specific industry solutions. In order to accomplish that goal, we have engaged in risk assessment and developed industry-wide contingency plans. In cases where there is little information about a service provider a higher risk is assigned.

Based on two years of risk assessment and close work with our members, NRF is confident that most larger, domestic retail firms have taken the necessary steps to ensure

their successful transition through the Year 2000 event. Moreover, our experience tells us that while most small companies may suffer isolated problems, they can probably survive by handling their work manually. It is mid-sized companies that are probably at the greatest risk for Y2K because they have grown to the stage where they must use technology but probably have the fewest resources to address problems.

Because NRF has been so involved in Year 2000 issues for the past two years, we have developed an extensive network of contacts both within and outside our industry, in the U.S. and internationally. NRF's experience has led us to the conclusion that Not-for-Profit entities like governments should generally be assigned a higher risk, and foreign countries are less likely to be Y2K compliant than the United States.

Because much of the merchandise that our members sell is imported from abroad, the retail industry's greatest concern is the global marketplace. Based on the information we have received so far, we anticipate that there could be supply chain disruptions in developing nations. Our members are aware of this situation and are developing plans to address any potential supply chain disruptions. It is possible that international legal issues could surpass those we find here at home, especially for the retail industry.

V. Conclusion

NRF's imperative is to ensure that the U.S. economy remains strong and that whatever can be done to facilitate a smooth transition across the Year 2000 event is done carefully, effectively and efficiently. NRF looks forward to working with both Subcommittees toward that important objective.

